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Politics this week

Oct 11th 2001
From The Economist print edition

America hits back

America, with Britain's help, began **military action** against Afghanistan in its quest to strike the Taliban and track down Osama bin Laden. Over several days and nights, bombers and cruise missiles hit targets associated with the Taliban and Mr bin Laden's al-Qaeda group. They also killed four Afghan workers employed by the United Nations' mine-clearing organisation and, it was reported, scores of civilians in the capital, Kabul, and the southern city of Kandahar. America said it had achieved air supremacy over Afghanistan.

See article: The war aims on the ground

Islamic reactions

Foreign ministers from the 56-member **Organisation of the Islamic Conference** held an emergency meeting in Doha, capital of Qatar, to try to formulate a united stand on terrorism and the crisis. They produced a mildly worded document that did not criticise the air strikes, attacked terrorism, but gave warning against extending the campaign to other Muslim countries.

See article: The Islamic view

Palestinian policemen in Gaza killed three protesters, including a 12-year-old boy, who were demonstrating in support of Osama bin Laden. Dozens of people were arrested, and the universities closed, but protests continued.

In **Pakistan**, several days of rioting in towns and cities near the Afghan border greeted the news of America's action. Four protesters died. Many others were injured. Protesters in **Indonesia** tried repeatedly to attack the American embassy and the parliament building. **Malaysia's** opposition Islamic party was moved by the strikes to declare a *jihad*. This could take many forms, including sending aid, clothing and medicine to Afghanistan.

See article: Musharraf's difficult path in Pakistan

The home front

Fear of **biological attack** increased in America as three anthrax cases were confirmed in Florida. One man died. The anthrax spores, found in the offices of a tabloid newspaper, were thought to be manufactured, not natural.

See article: Anthrax: old terrorism in a new form

President George Bush announced that only eight senior members of Congress would be provided with **classified information** about the war on terrorism in a bid to stop leaks that could put American troops at risk. Congress was cross, even though a classified briefing last week to the Senate Intelligence Committee later appeared in news reports.

The White House unveiled a list of 22 **"most wanted" terrorists**, including Osama bin Laden. The list is a joint effort by the FBI and the State Department to capture the suspects behind the terrorist attacks in

America, and is backed by a $5m reward for useful information.

Air disaster

An SAS airliner taking off in fog from **Milan's** Linate airport bound for Copenhagen crashed into a small plane on the runway, killing all 110 passengers and crew, all four people in the other plane and four ground workers.

Investigators have found fragments of an air-defence missile in the wreckage of a Russian airliner that crashed over the Black Sea on its way from Israel to Siberia, killing 78 people. **Ukraine** was holding military exercises in the region at the time.

Judges of **France's** highest court said that during his presidency Jacques Chirac could not be made to answer judicial questions even as a simple witness. He has been beset by mounting financial scandals that go back to his time as mayor of Paris in 1977-95.

Poland's ex-communist Democratic Left Alliance, which won the general election last month, formed a coalition government with the Peasants' Party.

Nearly two-thirds of **Italian** voters, in a turnout of barely a third, approved a referendum on constitutional changes proposed by the previous centre-left government that would give more power to the country's regions.

Bertie Ahern, **Ireland's** prime minister, said a referendum on abortion would be held in the spring. He expressed no intention to liberalise the law.

Syria's UN role

An overwhelming vote by the UN General Assembly gave **Syria** a two-year seat on the Security Council. Despite appeals from Congress, the Bush administration did not publicly try to stand in the way. Last year it blocked Sudan's candidacy, but Syria was the unopposed choice of the 50-country Asian group.

Investigations into a 1999 multi-billion dollar arms deal in **South Africa** were broadened. Michael Woerfel, of EADS, a European aerospace company suspected of providing politicians and officials with luxury cars, appeared in court in Pretoria, charged with corruption and forgery. The police said raids had been carried out on companies elsewhere in South Africa, and in France and Mauritius.

National reconciliation talks in **Côte d'Ivoire** were in doubt after three politicians, including two former heads of state, said they would not attend.

Denouement deferred

The presidents of **Brazil and Argentina** met to sort out yet another row about trade and the effect that the steady slide in Brazil's currency has upon it. The two men succeeded. Until the next time?

Opinion polls forecast a drubbing for **Argentina's** Alliance government in the mid-term congressional elections on October 14th.

See article: Argentina's Alliance government faces defeat

President Andres Pastrana of **Colombia** announced an extension—until January 20th— of the government's acceptance of the FARC rebels' control of their “demilitarised” zone in the south. Fresh talks will aim, for a start, at a six-month ceasefire.

See article: A kiss of life for Colombia's peace process

Non-combatant Japan

The parliament in **Japan** debated a bill that would allow Japanese troops to support military action—albeit limited to logistical back-up and not combat—even if it had not been sanctioned by the UN.

See article: Japan's prime minister is back in favour

Sri Lanka's president, Chandrika Kumaratunga, called a snap election, set for December 5th, to avoid a no-confidence vote after eight members left her coalition government.

China said it was planning to send an unmanned probe to the moon, with manned flights to follow within ten years.

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Business this week

Oct 11th 2001
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Rail crash

Reuters

Railtrack collapsed, after the British government refused to hand out any more funds to the much-criticised rail-infrastructure company. Railtrack, privatised in 1996, was put into administration; the government plans to replace it with a non-profit organisation. Investors, indignant that compensation had not been promised, threatened the government with legal action.

See article: Blood on the tracks

A government loan-guarantee scheme worth some $10 billion, part of an aid package for **America's airlines**, will allow wide discretion for its disbursement, including the taking of equity stakes by the government. Stronger airlines had wanted aid restricted for weaker airlines that might otherwise go out of business.

See article: Flying blind

The European Union issued tough rules for state aid to embattled **European airlines**. Governments may help out with extra security and insurance cover but broad subsidies will not be allowed. If, however, several European governments decide to flout the ruling, the commission may have difficulty stopping them.

Rules and regulators

America's Supreme Court rejected a plea by **Microsoft** to reverse a previous ruling that the software giant had broken antitrust laws. The government and Microsoft are trying to settle before the case goes back to court next March. Microsoft is in trouble with Europe's anti-trust regulators. It could face a huge fine and be forced to change its Windows software.

The European Commission had a busy week. It imposed fines of *euro*72m ($66m) on **DaimlerChrysler** for restricting supplies of cars, to stop dealers from selling them outside Germany in countries in which the vehicles command higher prices. A “block exemption” allowing car makers to use exclusive dealers, and otherwise hamper competition, expires in September 2002.

The commission also blocked the takeover by **Schneider**, a French consumer electrical-equipment maker, of a rival, **Legrand**. Since the two companies have already merged, they will be forced into a costly reversal of the process.

See article: A shocking denouement

Cards on the table

An American court ruled that **Visa** and **MasterCard** should not stop banks that belong to its network from issuing credit cards from rival companies. But the court did not agree that ownership of Visa and Mastercard networks by the banks was anticompetitive.

See article: Guilty as charged

Unilever Superannuation Fund, a pension scheme for employees of the consumer-goods giant, is pressing for a higher payout from Merrill Lynch Investment Managers in return for dropping a £130m ($189m) lawsuit alleging mismanagement of £1 billion-worth of funds. The pension fund is understood to have rejected an offer of £20m.

See article: Face Value

Shell company

Shell agreed to pay **Texaco** $2.1 billion for the half of Equilon, a refining business, that it did not already own and, with its partner Aramco, for Motiva, an American fuel business, making it the country's biggest petrol retailer. America's antitrust authorities had demanded the divestitures as part of the price of a merger between Chevron and Texaco.

Marks and Spencer, a struggling British retailer, had some good news for once. Sales in the latest quarter increased by 2.8% compared with a year ago—when sales were very weak—the first rise for three years. Its shares jumped by 10%.

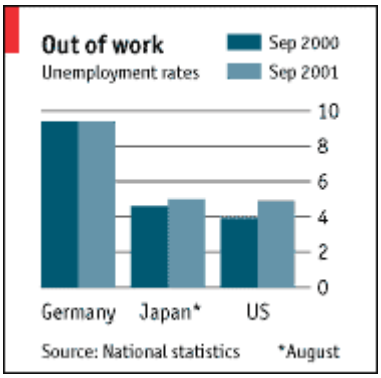
Cutting back

Credit Suisse First Boston announced third-quarter losses of $120m and a round of cost-cutting; 2,000 jobs will go, some 7% of the total. This has pushed losses at its parent company, Credit Suisse, to SFr300m ($177m) in the same period.

See article: A chill in the Alpine air

Lord Simpson, the ousted chief executive of **Marconi**, the troubled telecoms company that grew out of the old GEC, is to receive a controversial pay-off worth £2.8m ($4.1m) in cash and pension rights, including £1m from previous employers. Disgruntled shareholders, who have seen their shares fall by 99%, from £12.50 at their peak to 16 pence now, had hoped he would get nothing.

Job prospects looked shaky. **Unemployment** in Germany, Europe's biggest economy, hit 9.4% in September. America's unemployment rate was unchanged at 4.9%, but the employment figures suffered the biggest monthly fall since 1991, a drop that does not include the aftermath of September 11th.



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Fighting terrorism

The next phase

Oct 11th 2001
From The Economist print edition

After the bombing, the reaction—and then ground operations

"THE patient accumulation of successes." That phrase was one of the most notable and memorable from President George Bush's televised address on October 7th announcing the beginning of air strikes against Afghanistan's Taliban and the al-Qaeda terrorists they harbour. The military action that began that day was not going to be a single, massive attack and it should not be expected quickly to result in the surrender of the Taliban, or of Osama bin Laden, al-Qaeda's leader, or in a cessation of terrorist threats or attacks on America or its allies. The world's greatest military, economic and diplomatic power would steadily and relentlessly hunt down its enemy, while doing everything it can to maintain a coalition of support from a remarkably wide range of countries.

It was wise to set such a cautious tone. It was also wise to spend almost four weeks planning and preparing this first military operation. Truly powerful countries do not have to lash out wildly when attacked; indeed, to do so is a sign of weakness, not strength, for it is likely to be ineffective and to signify a short temper and attention span. All that also means, however, that this patient, relentless campaign is going to be hard to assess. The scorecard of accumulated successes is not going to be at all obvious, for some time to come.

It is better, then, to begin by assessing the accumulation of non-failures, for some sorts of failure could become obvious very quickly and are vital to avoid. The most important would be if military action were to provoke anti-American uprisings, notably in Pakistan and Saudi Arabia. One of al-Qaeda's goals seems to be the destabilisation of those two countries, because one holds nuclear weapons and the other holds oil and holy places. The video released by Mr bin Laden on the day of America's air strikes was plainly intended to stir up violence by Muslims against their rulers and against America (see article). So far, it has had only modest success. Protests in Pakistan and elsewhere were noisy on October 8th, but fairly subdued thereafter—even when news emerged that four civilian Afghans working for a United Nations agency had been killed during America's attacks on Kabul.

That might explain why on October 9th al-Qaeda put out a second call-to-arms by video. In the past, Mr bin Laden and his associates have been secretive and patient. This rush to the television screens suggests a new impatience, a sense that their best opportunity to garner support is now and, perhaps, that they have been disappointed by the reaction so far. Muslim governments, assembled in Qatar, may not have surprised al-Qaeda by their lack of condemnation of the American bombing, for the terrorists would include many of those governments on their list of targets. But the Muslim governments' moderate tone (see article) does suggest that they do not, at present, feel cornered by popular unrest. It is early days, of course: a lot of civilian casualties in Afghanistan, or some newly untoward action in Israel or Iraq, could push them in the other direction. So far, though, another of America's non-failures is that neither of those things has yet happened.

What might Osama bin Laden do next, if he really is disappointed? He could wait for an American mistake, such as the bombing of a hospital, and then try to exploit it. He could try to fake such a mistake himself. He could try to provoke unrest by some inflammatory action in Israel which would put America on the spot. Or al-Qaeda could commit further terrorist acts in America, Britain or other western countries. There is some fear that this may already have occurred in Florida, using anthrax spores (see article); even fairly small attacks can provoke widespread fear. Yet, even given his evil intentions, the case for such acts is not clear. In favour would be that to pull off more attacks would be a show of strength, and might impress some potential supporters. It would also show that al-Qaeda's threats had

to be taken seriously, since both this week's videos promised further fear and insecurity for the infidels. Against, however, would be the likelihood that such attacks would merely reinforce the coalition of countries against al-Qaeda and the Taliban that America has assembled.

In response to that possibility, all that America, Britain and others can do is to tighten the security around possible targets, and to warn people to be vigilant. Meanwhile, whether or not there are further attacks, the allies must continue, remorselessly, with the military advance in Afghanistan. Now that the Taliban's air defences, such as they were, have mostly been destroyed, as have other bits of military infrastructure, the next steps will be closer to the ground. The anti-Taliban Northern Alliance will seek to gain territory and to advance on the nominal capital, Kabul, though America may consider that a mixed blessing (see article). More important will be the beginning of raids by American (or American-led) ground forces inside Afghanistan, transported swiftly in and out by helicopter.

...and after that?

The aim of those raids will be to remove (or drive) the Taliban out of power, or at least out of control of the areas of Afghanistan where the Americans think they need first to look for al-Qaeda hide-outs. In the bleak, mountainous Afghan terrain, such raids will be perilous in the extreme. But they are likely to take place, even if the hope of finding Mr bin Laden and other terrorists is small. Merely to pin al-Qaeda down would be of benefit. And other governments or warlords in other countries may then be deterred from offering further sanctuary either to al-Qaeda or to other terrorist groups.

One country that is forever in the minds of America's military planners is Iraq. There is a strong temptation to extend the ambition of this operation to Iraq, in order to remove Saddam Hussein from power, eliminate his weapons programmes, and end the Arab belief that American-led sanctions are killing Iraqi children. That idea appears to tempt some officials at the Defence Department, but not at either the State Department or, for the moment, at the White House. The vague threat of it was contained in a letter from America's ambassador to the United Nations, John Negroponte, to the UN Security Council, in which he talked of the possibility of a wider war against other states that sponsor terrorism.

It is wise, and probably useful, to have put down a general marker of that sort. It may act as a deterrent against others. But it would be folly to go any further now. Unless there were strong and disclosable evidence of a link between Iraq and al-Qaeda's terrorism, a move against Iraq would destroy America's coalition. No Arab country could afford to remain supporters of the American action, and their desertion would be likely to lead to doubts, and intensified popular protests, in Pakistan. America may not need every member of its coalition, but it certainly needs the states surrounding Afghanistan. And it needs to ensure that countries that are currently co-operative do not in future offer homes to the terrorists.

A time may come when America can—and should—seek a better solution for Iraq than its current combination of sanctions and exclusion zones. But that is a long way off. Before then, what is required is a clear focus on the task at hand: dealing with the Taliban and al-Qaeda. In the month since the atrocities of September 11th, President Bush has handled that task well. He has shown an admirable and powerful patience. Now the successes must be accumulated.

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Muslims and the West

The need to speak up

Oct 11th 2001
From The Economist print edition

Faith cannot flourish without tolerance. Some extremist Islamists threaten to destroy both

AP

AMERICA and its allies are right to emphasise that their struggle against Osama bin Laden and his supporters is not a war against Islam. They must keep on saying it, not only because the claim is expedient—the fight will be much more difficult to win without the backing of moderate Muslims—but also because it is true.

The West has no quarrel with Islam. The West is secular, but this does not mean that it frowns upon religion in general, or on any religion in particular. Quite the opposite: the West values and protects all manner of religious belief. Millions of Muslims live in the West, and their right to worship as they see fit is a freedom which the allies ranged against al-Qaeda recognise as second to none. In other words, the West can live in peace with Islam. What is unclear is whether Islam can live in peace with the West.

Many Muslims in many parts of the world flatly say it cannot. The anti-western and specifically anti-American rage that animates the most militant strands of Muslim fundamentalism brooks no compromise. In his video broadcast this week Mr bin Laden took care to link the attacks on the United States with American support for Israel and the American military presence in Saudi Arabia, doubtless intending to suggest that, if those grievances were addressed, amity might prevail between Islam and the Great Satan. But if that is how you see the world, amity seems unlikely.

Militant Islam despises the West not for what it does but for what it is. If American “imperialism” were the principal bone of contention, why should the United States be so much more despised than the Soviet Union ever was, or than Russia still is, despite the fact that Russia rules over millions of Muslims who would rather not be its subjects? Europe, not America, you might argue, had “imperial” ambitions in the Middle East even after independent states had been created in the region: America crushed those ideas by humiliating Britain and France during the Suez crisis of 1956. Israel notwithstanding, America's supposed crimes of foreign policy in the region are utterly incommensurate with the hatred directed against it.

The truth is, America is despised mainly for its success; for the appealing and, critics would say, corrupting alternative it presents to a traditional Islamic way of life; and for the humiliation which many Muslims feel when they consider the comparative failure, in material terms, of their once-mighty civilisation. It helps Arab governments no doubt to blame that failure on outsiders. Plenty of western intellectuals are happy to agree that the economic plight of North Africa and the Middle East is more to do with American oppression than with its real, domestic, causes. (Causes that do not include Islam, by the way: blame decades of socialism followed by statism, corruption and incompetence.) Yet to think this way—to see the West as an infidel oppressor and capitalist exploiter, rather than as a partner with whom a fruitful friendship is possible—is to rule out all possibility of peaceful coexistence. Arab leaders and their western apologists should reflect on that.

Still, Muslims who think the West must be fought and defeated are not going to be bombed into changing their minds, that's for sure. And they are probably not going to be talked into changing their minds by outsiders. They themselves must examine their own history, and that of the West, if they are to see how an accommodation might be reached. Common ground will be hard to find unless most Muslims can deplore, in their hearts, apologies of any kind, active or passive, for the killings of September 11th. On the other hand, if the fundamentalist view of the West gains ground, people in the West might

conceivably be bombed into changing *their* minds—that is, into agreeing with Mr bin Laden that this is a war of civilisations that must be fought and won. A horrifying thought.

Say it loud

In all this, a particular responsibility falls on Muslims in the West. Most such Muslims, and nearly all of their leaders, have denounced the acts of September 11th in plain words. At the same time, they have spoken of their concerns for non-Taliban Muslims as the military actions against Afghanistan continue. That too is as it should be. But some Muslims in the West, a loud and therefore disproportionately audible minority, continue to speak for the fundamentalists, explaining and even trying to justify the crimes of September 11th.

It is crucial that the moderate Muslim majority deplores those views out loud, and publicly repudiates the people who espouse them. Any idea that loyalty to brothers in the faith must inhibit such criticism should be rejected. Mr bin Laden and his defenders are not championing Islam, they are defaming it. And without the tolerance that the terrorists seek to smash, no faith can hope to flourish in peace in this world.

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Australia's election

Who'll be lucky?

Oct 11th 2001
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Australia votes on November 10th. It's time for a change

Reuters

THE lucky prime minister? Until recently, the opinion polls had suggested that John Howard, the leader of the Liberal-National coalition that has governed Australia since 1996, would be sent packing by the voters this year. Suddenly, when Mr Howard started to push back asylum-seekers like a sea captain repelling boarders, the polls began to turn. And now, amid the dark uncertainties of a war against terrorism, he can argue that this is no time to switch governments. The voters seem inclined to agree. Are they wise?

Mr Howard's bunch deserves credit for one achievement: last year it brought in a goods-and-services tax—a sort of value-added tax—which has allowed a big shift from direct to indirect taxation, and with it lower income-tax rates and higher social-security benefits. The new tax, stoutly resisted and still unpopular, continues a series of reforms that was started by a Labor government under Bob Hawke in 1983 and has continued ever since, changing a highly protected, highly unionised resource-dependent economy into a strikingly open and competitive one. Unfortunately, a cynically voter-pleasing budget this year and the funking of the sale of the government's 51% stake in Telstra, the big telecoms company, suggest that Mr Howard's lot have lost their reforming zeal.

The bigger blot on their record, however, is their even more cynical decision to refuse refugees the right to seek asylum on Australian shores, and to pass them on instead to the Pacific micro-state of Nauru. Though the courts have sanctioned this policy, it plainly defies the spirit of Australia's obligations under the 1951 UN convention on refugees, which says that the right to asylum in any country can be claimed only in person in that country. The Howard government claims its policy is aimed at people-smugglers, not refugees, but it is hard to see it as anything but a populist attempt to win votes.

That there are xenophobic, if not outwardly racist, votes to be won in Australia is not in doubt. The anti-immigrant One Nation party, led by Pauline Hanson, has made an electoral impact more than once in recent years. Its successes, albeit always short-lived, and the surge of support for Mr Howard's hostility to refugees suggest that Australia is not yet the kind of multi-cultural country, at ease both with its Asian neighbours and with its own aboriginal people, that Mr Howard's Labor predecessors sought to bring into being. Yet this change was, and is, the necessary social and political counterpart to Australia's economic modernisation. Mr Howard seemed to sense this when he promised three years ago to commit himself to “true reconciliation” with the country's indigenous people. But that promise has come to naught, amid recriminations about his refusal to make a formal apology for the treatment meted out to aboriginals by generations of white Australians.

Labor has its blemishes too. It opposed the new tax, and promises changes to it, though they probably would not amount to much. It says it will not privatise Telstra, and it still has ties with Australia's less-than-enlightened trade-union movement. But in economic affairs Labor would probably not depart much from the path of modernisation that it started 18 years ago. And in helping to bring an end to the attitudes of the past—many associated with the white-Australia policy that characterised the country for so long—Labor would almost certainly be more successful than Mr Howard's team. If he does indeed turn out to be the lucky prime minister, Australia might just cease to be the lucky country—for a while at least.

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Business in hard times

The uses of adversity

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How to survive the downturn

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FEW businesses, large or small, are untouched by the change of outlook over the past few weeks. Many feel a new vulnerability, a new aversion to risk and a new awareness of the fragility of a just-in-time economy. Everywhere, managers are wondering how to adjust not only to the immediate uncertainty but also to a much darker future.

For the weaker, the disaster will be a killer. Most obviously, some of the world's airlines look unlikely to survive (see leader). A number of hotels, car-rental companies and conference organisers also seem sure to go under this autumn. So might quite a few insurers. Most businesses can live with a sudden hit, or a fall-off in demand, of the order of 5% or even 10%. To cope when demand drops by half is a different proposition, and many will not manage it.

For the survivors, the prospect is still one of long-drawn-out uncertainty—about both the depth of the downturn and its duration. Both will depend partly on political and military events. But already companies are citing the terrorist attacks as a reason for dropping mergers, cutting jobs and ditching new projects (see article). Yet the world economy was slowing sharply, and demand was falling, long before September 11th. American manufacturers and technology companies have lived with recession for the past year. Much of the fall in American consumer confidence in September occurred in its first ten days. Terrorism and the war against it are now being blamed for problems that were much deeper-rooted.

Indeed, the shock may actually bring some benefits, by giving companies a great excuse to advance adjustments that were already long overdue. By scrapping deals and terminating jobs faster than they would otherwise have done, American companies may pull through to recovery more quickly. In any case, wise companies should assume that their troubles are caused mainly by recession—something that has happened before, and that will disappear in time—rather than by permanent new patterns of consumer behaviour. One day, people will travel and shop as assiduously as they did before.

Even so, the events of September 11th will leave a mark. For the next few years, many companies will seek security and certainty. Some lessons learnt in anticipation of the millennium-bug disaster that did not happen will be revived. Critical computer systems will be triplicated, not just duplicated, and kept physically separate: the Bank of New York had two clearing systems, with different telephone and power supplies, but both were in lower Manhattan and were disabled after the attacks. Companies will want to know where their staff are, and will think twice about allowing all their top teams to work in the same office building. Outsourcing contracts will be rewritten, to clarify provisions on disaster recovery. Supply chains will be redesigned, to make them less vulnerable to disruption. Security checks will be increased.

Many of these changes will build in redundancy. They will therefore add costs and reduce efficiencies at a time when companies can ill afford either. But the bigger issue for most firms is how best to manage through hard times. This is a skill that has gathered dust over the past decade. Today's western bosses were mostly middle managers or lower in the previous downturn; today's middle managers were fresh-faced newcomers. Some of the world's biggest companies, such as Vodafone and Cisco, are essentially children of the good times, with no corporate memory of how to ride out a downturn.

Companies need that memory, because running a business in bad times is tougher than managing in

good. Bad times force companies to make hard choices. So far, many have made the easy ones: scrap advertising, stop capital spending, cut business travel. But companies will eventually need to advertise, invest and travel once more. Instead, they should now start asking nasty questions about which staff should stay and which should go, which offices should close and what products they should stop making.

Time for the Shackleton approach

After that, they need to keep up morale. That means, among other things, finding clever ways to retain their best staff (allowing temporary sabbaticals on reduced pay, for example) until the next upswing. The good boss will emulate not one of last year's management pin-ups, such as Jeff Bezos or Richard Li, but the unpretentious Ernest Shackleton, a rival in early 20th century Antarctic exploration of the more vainglorious Robert Scott. As one popular new management book explains, Shackleton found various ingenious ways to sustain the morale of his men through a winter marooned in the Antarctic, by keeping them occupied and enthusiastic, and carefully controlling the disgruntled. Scott may have reached the South Pole, but his entire team died; Shackleton rescued all his men after an extraordinary voyage to find help. The skills required to lead people through dark adversity may be less glamorous than those needed in a glittery boom, but they are a truer test of managerial talent.

For downturns provide opportunities as well as hazards. Recessions do not last forever. This one will probably be on the retreat a year from now. Meanwhile, companies with the money to make acquisitions, whether of businesses or of good people, will find bargains. If they are not too disoriented to take some risks, they will benefit when the sun comes out again. New ventures launched today will be designed to cope with the rough as well as flourish with the smooth. Managers who do well over the coming months will become the stars of the coming years. It is in the early stages of an upturn that fortunes are most easily made. This is the moment when companies should be preparing to make them.

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Airlines

Flying blind

Oct 11th 2001
From The Economist print edition

How to exploit the airlines' current troubles to reshape the entire industry

AP

CALL it the bin Laden excuse. Lots of companies are blaming all their troubles on the events of September 11th. But for the industry most directly affected, the airlines, the bin Laden excuse risks turning into a reason to justify unwise bail-outs and postponement of much-needed restructuring.

The world's airlines are in far worse shape now than they were even during the Gulf war in 1990-91. Before September 11th, they were expected to lose around $3 billion this year. Now they are staring at losses of $10 billion or more. Job cuts in the industry may soon reach 200,000, almost 12% of the airlines' pre-attack workforce. Just as in the Gulf war, the understandable response of most governments has been to step in with subsidies to keep the airlines flying. The American government has offered $5 billion in cash and a further $10 billion in loan guarantees (although, since the government has taken powers to get equity stakes in exchange, not all airlines will be keen to fall back on these).

This week the European Commission took a rather tougher position than the Americans. It says it will permit state aid only to compensate airlines for business lost in the four days after September 11th, to offset higher security costs or to underwrite extra insurance costs, although it is also relaxing the rule that airlines should lose any take-off slots that they stop using. But the Belgian government has already followed the Swiss in coming up with emergency support for its bankrupt flag-carrier, Sabena, and the Irish and several others may soon follow. Such subsidies may be challenged in court, thanks partly to complaints from other airlines. But the chances of the commission being politically forceful enough to make its hard line stick look quite small.

That is a great pity, for on both sides of the Atlantic the industry needs intensified competition far more than it needs extra subsidy. Above all, it needs governments to pull back from their habitual meddling rather than to increase it. The high capital costs and low profitability that plague most established airlines are a holdover from a bygone era of heavy government regulation, state ownership and lousy industrial relations. To cite only one of the more egregious cases, the strike-ridden, high-cost Sabena has made a profit only twice in its 75-year history. An industry that was, at least until the blip of September 11th, growing by 5% a year, needs to shed all such past baggage if it is to prosper.

Going for broke

The right way forward would start by letting more airlines go under. Rather than dole out indiscriminate subsidies that benefit mainly shareholders and already well-paid staff, it would have been better to push most American airlines into chapter 11 bankruptcy. That would have given a breathing-space in which to sort out how many ought to survive, and in what form. In Europe too, the worst flag-carriers, such as Sabena and Aer Lingus, should now be allowed to go bust or be taken over rather than being kept alive on artificial support.

The next step should be to dismantle the network of regulations that have for too long stood in the way of change in the industry. America should open up its market to foreign competition, dumping restrictions on foreign ownership of domestic airlines and allowing foreign airlines to compete internally. The

Europeans should jettison their web of national bilateral treaties with America and negotiate a genuine open-skies deal, at EU level. That would allow Air France, for instance, to fly to America from London or British Airways to do the same from Paris. Cross-border mergers should be permitted and even encouraged. And instead of suspending the use-it-or-lose-it rule for take-off slots, they should be auctioned to the highest bidders, which will probably be low-cost airlines.

Indeed, the rapid and profitable expansion of low-cost airlines, offering basic point-to-point service, has shown wonderfully well what can be achieved with a business model that delivers what customers actually want. Ryanair now has a higher market capitalisation than British Airways. Instead of coddling inefficient incumbents through this difficult period, the world's governments need to expose them to fiercer competition. The winners would be the flying public.

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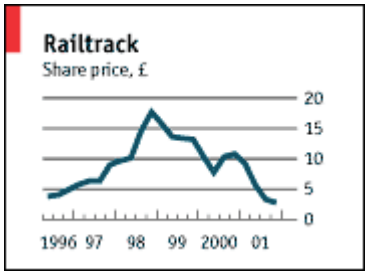
Britain's railways

Failtrack

Oct 11th 2001
From The Economist print edition

The government is renationalising Britain's railway infrastructure, and might as well admit it

Get article background



BRITAIN invented privatisation, and for the past decade and a half has been teaching less advanced nations how to turn state-owned wastrels into efficient private companies. Yet on October 7th, after a year of disruption on the railways that has left the stiffest of upper lips trembling with fury, the government announced that Railtrack, the privatised owner of Britain's railway infrastructure, was going bankrupt. How can this have happened?

Railway privatisation, which divided the industry into more than 100 companies and separated the track from the trains, was rushed through by a Conservative government in 1996 to get it out of the way before an election which the Tories knew they were going to lose. The company was sold on a false premise. The true cost of providing a safe, modern and efficient network was never properly assessed, for fear of frightening off investors—which it would have done. For years the treasury had withheld the funds needed to modernise the tracks. As a result, the railways were in a poor state. That is the main reason why Railtrack has always had the begging bowl out, and why the government has made it bankrupt.

Dreadful management made things worse. Top jobs went to executives with no knowledge of the industry; they called in consultants to advise them with no knowledge of the industry. Costs—especially those associated with the £2.3 billion ($3.3 billion) investment on the West Coast main line—got out of control, tripling the total bill.

Even if the railways had been impeccably managed and in tip-top condition, privatising the tracks would have been a mistake. Unlike the operating companies, which benefited from their new freedoms to expand services and boost traffic, Railtrack, a monopoly operator of an essential service, was never going to escape from political control. It was so tightly regulated that it had little scope for increasing its income, and ministers demanded improvements in performance and expensive new safety measures without giving the company the freedom to make money to pay for them.

Own up, you own it

Furious that the government pulled the plug, Railtrack is portraying the announcement of its insolvency as shoddy, and shareholders have complained that it amounts to expropriation. Some may sue. They are unlikely to get anywhere in the courts, but they may get half the diminished value of their shares when the company is wound up (see article).

A re-born Railtrack can now no longer operate as a private-sector company in the usual sense of the word, but it has to go on operating. The government, however, is determined not to take it back into state ownership. In a parody of a “third way” fudge, it is talking of a “new private company without shareholders”. Fancy names may enable the government to keep Railtrack's liabilities off the public-sector borrowing requirement, but the fundamental issue cannot be fudged. Railtrack has the same problem as it had in 1996. It needs investment or its performance will deteriorate still further.

However the government chooses to describe the status of the son of Railtrack, it is not private shareholders who will finance this new company: it is the bond markets. The government will, in effect, have to underwrite any future investment, which means that the rail network has been renationalised in

all but name.

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Letters

Oct 11th 2001
From The Economist print edition

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Rights and terrorism

SIR – You correctly identify one of the key challenges for governments in dealing with the threat of terrorism—how to respond to the terrible crime against humanity committed on September 11th without undermining the very freedoms and liberties that the terrorists sought to destroy ("Liberty v security", September 29th). The attack was against more than just buildings and people. It was an attack against fundamental values that now, more than ever, need to be protected and reinforced.

However, in asserting that civil libertarians need to accept a balance between security and liberty, you underestimate the true balance already built into the human-rights system. The drafters of the Covenant on Civil and Political Rights, and similar provisions in other documents such as the European Convention on Human Rights, may not have anticipated the horrific events of September 11th but they did provide for them. Existing human-rights law addresses the issue of competing values and allows some limitation of certain rights to respond to pressing public or social needs, but not so as to jeopardise the essence of the rights concerned.

In the past, the need to oppose terrorism has sometimes been used to justify unacceptable actions by states. I endorse Colin Powell's reported comments to the effect that global action against terrorism does not constitute a licence to violate human rights. Not only can the eradication of terrorism and the defence of our most cherished values be pursued simultaneously, indeed they must.

Mary Robinson
UN high commissioner for human rights
Geneva

SIR – An "attack on freedom" can best be repelled by protecting individual liberty energetically, not diminishing it. National identity cards, expansive police surveillance powers and other control measures at best offer a false sense of security. America's Founding Fathers, nursing fresh wounds suffered in the revolutionary war, decided to impose sweeping limitations on government power in the Bill of Rights. They believed a powerful government in itself was an "attack on freedom". On September 11th Americans learned that the true price of their constitutional liberties is eternal vigilance, not only over terrorists but also others who urge sacrificing liberty for an illusory security.

Al Mariam
California State University
San Bernardino

Funding terror

SIR – Many of the sources of funding for terrorist activities are other illegal activities, such as drug trafficking ("Getting to them through their money", September 29th). This is true in Afghanistan, and also Colombia, where the two guerrilla groups and the paramilitaries get much of their money by taxing the drug trade. One of the best ways to attack terrorism is to cut off funding. One method would be to legalise drugs. Maybe the American public is ready to understand the grave implications of keeping drugs illegal.

Andres Marulanda
New York

Alliances: old and new

SIR – You quote George Bush as saying “The United States has no more important relationship in the world than our relationship with Mexico” (“Fair-weather friends?”, September 22nd); in the same issue, America's ambassador to Canada is quoted as saying “You are truly our closest friends” (“Setting a new perimeter”); and Mr Bush is also reported as saying “America has no truer friend than Great Britain” (“Who gains?”, September 29th). Truth is, indeed, the first casualty of war.

Mark Pike
Alton, Hampshire

SIR – Rather than be envious of the “special relationship” that Britain shares with America, Europe should be relieved (“Who gains?”, September 29th). As a trusted ally, Britain has regularly tempered the thoughts and deeds of America on the world stage. This partnership will form the core of the multilateral effort Europe wants. Will Rogers said that “America never lost a war and never won a conference.” Co-operation among nations will be the key to victory in a war on terrorism.

David Rosen
Hoboken, New Jersey

American interventionism

SIR – Your article on the impact of September 11th on the IMF and the World Bank was shallow in one respect (“Bribing allies”, September 29th).

You imply three phases. First, cold war: extensive American interventions in the two organisations, driven by superpower geopolitical considerations. Second, post-cold-war: interventions “mercifully rare”. Third, post-September 11th: renewed interventions in the organisations, driven by anti-terrorist geopolitical considerations. You picture the second phase as untroubled by America's discretionary intervention in the IMF and the Bank. On the contrary, it intervened heavily in the Bank and the Fund during the second half of the 1980s and through the 1990s, but more with the aim of building up its credit with domestic lobbies than to meet geopolitical objectives. The Treasury fed them (especially the Bank) to American NGOs and Congress, and some European states and NGOs joined in. These interventions were justified under the banner of “civil society” being as—or more—legitimate than the elected governments of developing countries and their state representatives.

The question now is how the apparatus erected for the second phase will survive in the third (eg, the Bank's Independent Inspection Panel, and its protocol of consultation with NGOs about country-assistance strategies, which in some cases has gone with the sidelining of the government). Unkind people might observe that al-Qaeda is an NGO, and one with extraordinarily high levels of social capital.

Robert Wade
London School of Economics
London

Children's television

SIR – To assume that the BBC is dictated to by commercial pressures when making children's programmes is wholly incorrect (“Join the crowd”, September 15th). The BBC only ever commissions programmes with the aim of serving our licence payers and the original idea is of paramount importance when commissioning programming for this dedicated audience, not licensing and merchandise opportunities.

The two CBBC digital channels will offer up to 90% originally produced programming across all the genres. Between its digital and analogue services, the BBC will spend almost £100m on new programming for children in Britain over the next year. None of the other British children's channels have committed to this level of investment despite being part of multimillion-dollar organisations.

Nick Jr may have a relatively high percentage of domestic programming, but the majority of the

programmes are acquired—some from the BBC—and not made by Nickelodeon. CBBC will always offer benchmark, quality and innovative programming—free of advertising and sponsorship—where the original idea is the overriding priority.

Nigel Pickard
Controller, Children's BBC
London

Ecuador's shaky economy

SIR – Your article about the prospects for Ecuador after dollarisation misses several key points ("Squandering an unlikely recover", September 15th). First, more than 1m Ecuadoreans (out of a total of 12m) have fled the country to look for jobs overseas. As a result, there are fewer working-age individuals, and therefore the rate of unemployment appears to have fallen. Second, those who have moved abroad send money to their relatives in Ecuador. Last year, these transfers exceeded $1.2 billion, second only to oil as a legal source of dollars.

Third, those who have got their money back after the freeze on bank deposits imposed by the previous administration are reluctant to save or invest in Ecuador's financial system. Instead, there is a surge in imports. Last year, Ecuador had a negative trade balance for the first time in three decades.

Fourth, and probably most important, dollarisation has made it particularly easy to launder drug money. Property, vehicles, farms and small businesses are being sold to Colombians for cash. The inflow of dollars from oil, migrants' transfers and drugs has kept the economy afloat, despite a substantial drop in other exports led by a strong dollar.

Ivan Grijalva
Quito

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Fighting terrorism

Keeping all options open

Oct 11th 2001
From The Economist print edition

EPA

The first week of American attacks went almost by the book. Yet as time goes on, the alliance may find it harder to hold together

THE reactions to America's first round of air attacks were sobering in their variety. President George Bush said that battle had been joined “on many fronts” and called the operations “sustained, comprehensive and relentless”. His defence secretary, Donald Rumsfeld, cautioned that “air strikes alone probably won't dislodge the Taliban” or kill Osama bin Laden. He repeated the administration's view that these were opening shots in a long, fluid conflict that might one day spill beyond Afghanistan's borders.

In Pakistan, General Pervez Musharraf took a different view. He told his restless countrymen that “I have got definite assurances that this operation will be short.” Reflecting the hopes of Islamic states, he added that “it ought to be targeted.” The Jordanian government was one of the few Arab regimes to support the action explicitly; yet King Abdullah, at a meeting with the Syrian president, said terrorism should be dealt with by “political and security means”. More striking perhaps, since his country had taken a prominent part in the attacks, Britain's foreign secretary, Jack Straw, insisted that “the agreement at the moment is that [action] is confined to Afghanistan. That is where the problem is.”

These are not flatly contradictory views. The Americans are talking about a broad campaign of which military action is just a part; General Musharraf is talking about the military actions that began on October 7th. Still, for supposed allies to react so differently suggests that almost all the members of the coalition, save the most important one, are hoping that the overthrow of the Taliban will be quick and relatively painless. That seems unlikely.

Compared with the potential firepower assembled around Afghanistan, the first four days of strikes were relatively modest (see article). But the attacks intensified in the early hours of October 11th. Residents of Kabul reported a terrifying night of continuous bombardment; at least 30 bombs and missiles fell on Kandahar. The strikes wrecked the Taliban's command-and-control system and destroyed seven of Mr bin Laden's largest (empty) training camps, though Mr bin Laden and his protector, Mullah Muhammad Omar, were reported to have merely decamped from their base at Kandahar to “a secret place” elsewhere in Afghanistan.

The Pentagon was satisfied that, having achieved air supremacy, it could move towards the second stage of operations: striking Taliban troops, giving air support to any opposition advance and, possibly, sending in its own soldiers. American officials are preparing to send helicopter gunships to bases in Uzbekistan from where they could help the anti-Taliban Northern Alliance, though the Uzbek president has said he is “not quite ready for this”. But whether such actions would bring a swift end to the Taliban, or produce a stable government in Kabul, is another matter.

The Northern Alliance may not be capable of holding Kabul—and America may not want it to, even if it could. There are signs that America may be trying to restrain the Uzbek- and Tajik-dominated alliance from capturing Kabul until anti-Taliban forces from the majority Pushtun group, from which most of the Taliban come, are ready to join in. To the frustration of the northerners, America seems to have held off from bombing Taliban positions around the Bagram airfield, just north of Kabul; if these positions were bombed, the capital might swiftly fall.

Widening war-aims?

The Pushtun leaders could change their minds about joining in, of course, if the Taliban were to retreat or, better still, fall apart. For the moment, though, the situation on the ground is sufficiently confused that nervous members of the alliance may well not see their hopes of a quick, clean victory realised. Their enthusiasm will be further tested by four other developments, both inside and outside Afghanistan.

The most immediate worry is about American intentions. The country's new ambassador to the United Nations, John Negroponte, prompted concern by delivering a letter to the UN saying the investigation into terrorism might prompt America to take military action against targets beyond Afghanistan. This seemed to confirm the fears of Arab states that the United States was about to strike at Iraq.

Those fears, at least, are overdone. American officials argue that this was not a letter of intent to widen the war beyond al-Qaeda, but merely notification about keeping options open at an early stage of an investigation when they still know frustratingly little about the organisation's real reach and support. If the key to al-Qaeda turns up elsewhere, they do not want to have tied their hands in advance.

The letter's other purpose was to deter Iraq from mischief-making while America's attention is elsewhere. On the day he delivered his letter to the UN, Mr Negroponte also met Iraq's UN ambassador—the first meeting between American and Iraqi diplomats for years. He told him that if Saddam Hussein tried to assist the Taliban or al-Qaeda, or if he threatened his neighbours or domestic dissenters, America would retaliate. That does not mean the administration has made up its mind one way or the other on how to handle Iraq in the long run. But it is not seeking to widen the war on terror now.

The second test of the alliance may be more serious. It comes from the looming humanitarian crisis within Afghanistan. Both Mr Bush and Tony Blair, the British prime minister, have suggested that the wider campaign will be measured partly by the world's ability to deliver food to hungry Afghans. This matters not only morally, but as a way of demonstrating that the allies are not at war with ordinary Afghans. Morever, another flood of Afghan refugees into Pakistan could strain that country to breaking point.

So far, the air drops have made almost no difference to the hunger. This was only to be expected, since Afghanistan has been desperately short of food for years. When around 7m Afghans are threatened with starvation, pushing 37,000 meals a day out of cargo planes is an air drop in the ocean. Médecins sans Frontières, an international relief organisation, dismissed the effort as propaganda. Mr Rumsfeld conceded that the only way to deliver enough food aid was by road, and that will require holding enough territory to keep convoys free from attack by the Taliban (or even the Northern Alliance). That point seems far away.

The third test of the alliance is coming from Mr bin Laden's own response to the air strikes. Hours after they began, he issued a chilling video celebrating the attacks on New York and Washington as “America struck by almighty God in its vital organs”. He also seemed to threaten further terrorist action by ending his speech with this: “I swear to God that America will not live in peace before peace reigns in Palestine and before all the army of infidels departs the land of Muhammad.”

The pre-recorded tape was evidence that Mr bin Laden had expected air strikes and planned his response. He has a history of signalling his intentions by visual clues. Before the attack on the *USS Cole* in Yemen, he appeared in a video bearing a Yemeni knife. This time, he wore an American army flak jacket.

The anthrax outbreak in south Florida may already be the first case of biological terrorism (see article). American researchers say the strain of the bacillus found is more common in laboratories than in the wild. That strongly suggests, though it does not prove, that the disease was planted deliberately. It does not, of course, show that members of al-Qaeda were responsible. But the flight schools where several of the September 11th hijackers trained are nearby. And even if this turns out not to be the work of al-

Qaeda, American intelligence officials have told members of Congress that further terrorist attacks are certain.

Inflaming the Arab streets

Such attacks will only stiffen the resolve to get Mr bin Laden and his cohorts. But the terrorist's intent may be to inflame not just America, but the Arab streets. That was made clearer by the release of a second video, on October 9th, in which another al-Qaeda member, Sulaiman abu Ghaith, repeated the threat of further hijackings, claimed that “there are thousands of young people who look forward to death” and called on Muslims everywhere to “uphold their religion” by attacking America. “From today onwards,” he said, “the *jihad* has become a duty for all Muslims.”

Reuters

Propaganda strikes too

It would be wrong to say that such words have yet inflamed Muslim public opinion to the point where it threatens any regime. There were serious outbreaks of violence, certainly—the worst in Pakistan, where 10,000 Taliban supporters rampaged through Quetta leaving four people dead, and Palestine, which experienced its biggest internal upheaval since 1994. These riots demonstrated why fragile Arab regimes are nervous about the reaction from the streets. But they also showed something else: the ability of regimes to face down the threat. Neither in Pakistan nor among Palestinians did the violence stop leaders taking decisive action against supporters of the Taliban. General Musharraf replaced several high-ranking military officers with close links to the Taliban (see article). And Mr Arafat's decision to crack down on the rioting students with unusual force—three people, including a 12-year-old, were killed—shows the importance he gives to his alignment with the American-led alliance.

The reluctance of America's main Arab allies to give technical support to the air strikes remains a worry. In his speech, Mr Bush could not publicly name a single Arab partner in his list of countries from whom he had had such backing. But there may be an explanation. It is notable that two of the regimes which have most openly supported strikes in principle—the Palestinian and Jordanian ones—were on the other side in the Gulf war. They have much to gain now by siding with America. By contrast, those which vigorously backed the war against Iraq, notably Saudi Arabia, have been among the silent partners. But Saddam Hussein threatened the order of states within the Arab world. To resist that, they needed help. Mr bin Laden does not threaten the Arab order so directly. Rightly or wrongly, they may feel able to combat the threat he poses without openly supporting America.

That does not necessarily mean their support will always be qualified. American officials privately say that some initial Arab hesitation was caused by fear that the administration would not be resolute enough—that is, that it might balk at killing Mr bin Laden as it balked at overthrowing Saddam Hussein. The Americans say that while, in public, Muslim leaders say they do not want the war extended to other Muslims, in private they wanted reassurances that Mr Bush would not (as they delicately put it) end the war prematurely.

It is hard to know how long this private support will withstand popular discontent. But it must hold for a while yet. America's actions seem to be succeeding in the air, but on the ground they have hardly begun to create conditions for a stable Afghan government. The fourth and biggest test of the alliance is still to come.

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The attacks on Afghanistan

So far, so fairly good

Oct 11th 2001
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AP

The skies have been won. On to the next stage, which will be tougher

Get article background

FOR a war effort that has been billed by its American and British instigators as a long, complex and grinding affair, the military campaign against the Taliban has got off to a brisk start. On October 9th, the third day on which targets in Afghanistan were pounded with bombs and missiles, America's defence secretary, Donald Rumsfeld, declared that “air supremacy” had been achieved. The Afghan regime's puny air defences, and its tiny air force, have been disabled to the point where the United States could carry out air operations “around the clock, as we wish”.

Among the objects struck during the first blitz were airfields, radar and communications systems, barracks, terrorist training camps (mostly empty), the home in Kandahar of the Taliban's spiritual leader Mullah Muhammad Omar (who was unhurt) and, to the great embarrassment of the allies, a UN mine-clearing office in Kabul where four local staff were killed.

The number of aircraft involved in the onslaught—40 on the first day and barely half that number on subsequent days—pales beside the American-led air armadas which took on Serbia in 1999 (300, later rising to 1,000) or the 2,500 deployed against Iraq in 1991. In the words of Andrew Brookes, an air-war specialist at the International Institute for Strategic Studies in London, “this is not a target-rich environment.” But the pace of bombing was sharply accelerated early on October 11th. Among the targets were Kabul airport and military bases east of the city, as well as government offices in Kandahar.

Unlike Serbia or Iraq, Afghanistan does not have many places of military or political importance that are obvious targets for bombing. Nor is it a well-organised state whose leaders can be induced to sign a surrender and then use their authority to fulfil its terms. Although aerial bombing has proved to be an effective way of constraining the behaviour of some governments, there may be limits to its effectiveness against failed or semi-failed states. For all those reasons, American and British officials have been stressing that the bombing of Afghanistan is only the opening phase in a multi-dimensional conflict.

All the same, the choice of aircraft and munitions reflect some of the lessons of the war over Kosovo. Big, heavy, long-range bombers—the B-52 and B-1, based on the island of Diego Garcia in the Indian Ocean, and the B-2, based in Missouri—are playing the most spectacular part. They have been joined by two types of light, versatile carrier-based fighters, the F-14 and F-18, which will play a bigger role as the battle for Afghanistan heats up. Mr Rumsfeld noted an intensifying search for “targets of opportunity”—targets that present themselves unexpectedly—as America consolidates its mastery of the skies over Afghanistan.

Conspicuous by their absence from the list of aircraft deployed have been the land-based tactical fighters like the F-16 and F-15, whose use would have required permission from nervous Middle Eastern states. Political problems of this sort highlight the advantages of launching attacks from the high seas. For valuable fixed targets (such of them as exist in Afghanistan), the allies' weapon of choice is the cruise missile, fired from American and British submarines as well as American aircraft and surface ships.

On the face of things, the American-led effort appeared at mid-week to be making good progress towards achieving several of the objectives carefully spelled out by Mr Rumsfeld on October 7th, as the air operations began. As well as simply punishing the Taliban regime for harbouring the al-Qaeda network, the campaign aimed to “acquire intelligence to facilitate future operations” against both the terror network and the regime; to make it harder for Afghanistan to be used as a terrorist base; and to “alter the military balance” inside Afghanistan by destroying the Taliban's weapons and “developing relationships” with the anti-Taliban opposition.

The last two aims, in particular, were being pursued with some success. The Taliban suffered painful blows in the form of attacks on Kandahar, their main stronghold, and on clusters of government troops dotted around the edge of the country in places like Herat (which the Taliban was said to be abandoning) and Shindand in the west, Sheberghan and Kunduz in the north and Jalalabad in the east.

Emboldened by these attacks, the Northern Alliance of anti-Taliban forces claimed on October 9th to have cut the regime's main north-south supply route, through the western Baghlan province, after the defection of 1,200 troops who had previously been loyal to the regime. Speculation mounted that the regime would soon abandon the northern city of Mazar-i-Sharif, where American strikes seem to have had a devastating effect. The Northern Alliance said the regime's morale had fallen after the death (as the alliance claimed) of the air-force minister, Akhtar Mukhamed Mansur, and 40 of his comrades in Mazar-i-Sharif. The alliance also asserted that, after this setback, the Taliban had abandoned the town of

Panjkaria and 11 smaller villages.

Meanwhile, American officials made it known that 1,000 men of the 10th Mountain Division were on their way to Central Asia, to join 1,000 already in the region. Britain's defence secretary, Geoff Hoon, pointedly said that his country was not ruling out the use of ground troops.

All this suggested that the conditions were in place for a rapid “alteration in the military balance”, to use Mr Rumsfeld's language, and that the Taliban might well be forced to abandon Kabul—a city for which the Islamist regime, whose ideologues are still firmly based in Kandahar, has never had any particular affection. But Afghan-watchers have been issuing stern warnings against the assumption that everyone's problems will be over as soon as anti-Taliban forces reoccupy the capital. “Nobody should make the same mistake as the Soviet forces did [when they invaded Afghanistan in 1979] and assume that, once you have Kabul, you have the country,” says Edward Girardet, a writer with long experience of Afghanistan.

The reasons for caution

For one thing, whatever remains of the Taliban's army may find it possible to hole up in the mountains and harass whatever regime takes power in the capital. Worse, the Taliban might abandon power in Kabul but still find it possible to subvert Pakistan by appealing to fellow members of the Pushtun ethnic group, which dominates the adjacent Pakistani provinces.

For another, there is a risk of bitter internecine fighting between the various constituents of the emerging anti-Taliban coalition. These include the Tajik and Uzbek elements (supported by their ethnic cousins in ex-Soviet Central Asia, as well as by Russia), and the Shia communities, horribly oppressed by the Taliban, who enjoy some backing from Iran. Then there are Pushtun groups and commanders who dislike, or have defected from, the Taliban but have no wish to see their Uzbek or Tajik rivals take power in their country.

Before the American air attacks, moves were afoot to form a Pushtun opposition to the Taliban, ranging from local bosses in the provinces north of Kandahar to Abdul Haq, a veteran of the anti-Soviet struggle who recently returned to Peshawar from Dubai. All these quarrelsome Pushtun groups share a keen dislike of the idea of the Northern Alliance storming into Kabul in the wake of the western air strikes. Many Pushtuns hope for the return of Afghanistan's ex-king, Muhammad Zahir Shah. This solution has also been mooted by the American government. But, among Pushtuns in the war zone, there is intense suspicion that the Americans may allow their Tajik and Uzbek compatriots to take power with or without the king. General Pervez Musharraf, the Pakistani president, is equally dismayed at the thought of a Tajik-Uzbek victory, saying it would mean “a return to the anarchies and the atrocities of the past.”

On the other hand, many people in Russia, which for decades has been competing with Pakistan for influence over Afghanistan, would presumably welcome a rapid march into Kabul by the Northern Alliance. If the fighting gathers pace, that outcome might be difficult to prevent.

Tim Ripley, a defence commentator for Jane's Information Group, believes that fine-tuning political developments inside Afghanistan is at most a secondary objective for the American-led campaign. Its biggest priority, he believes, is to create secure areas, even quite small ones, in which western special forces can land safely and carry out “search and destroy” operations against rebel camps, and possibly against Osama bin Laden himself.

A fresh hint of the Americans' aims came on October 10th, when officials at the Pentagon said they planned to deploy helicopters in Afghanistan—including the Apache “flying tanks”, which could fire rockets at groups of Taliban or al-Qaeda fighters, and UH-60 Black Hawks, the helicopter of choice for special forces' operations. As these choppers go into action, it may become a bit clearer what Mr Rumsfeld has in mind when he insists that America “has no aspiration to occupy or maintain any real estate in that region. We are simply trying to root out terrorists.”

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About sponsorship

The Northern Alliance

At the ready

Oct 11th 2001 | THE KALAKATA HILLS
From The Economist print edition

A primitive army foresees its finest hour

Reuters

Get article background

TAKE the dusty road that runs behind the Kalakata hills, just south of the border with Tajikistan, and it is hard to believe that you are on the front line. Except for the occasional desultory exchange of tank and artillery fire, everything seems asleep. But the silence is deceptive. In dusty, mud-brick compounds here and there, thousands of troops of the Northern Alliance are ready for action. Very soon, they expect, orders will be given to launch a major assault against the Taliban, perhaps a strike as far as Kabul itself. Although their new American allies may have doubts that they will be ready or capable, they themselves are brimming with optimism.

In the compound belonging to the Mazar-i-Sharif 01 Brigade, troops are putting the finishing touches to one of their most important pieces of equipment: wooden rakes, five metres long. When the advance begins, the first soldiers to move forward will use them to clear a path through Taliban minefields.

General Abdul Manon, the leader of the 01 Brigade, sits cross-legged on the floor among his men. On the wall behind him a slogan, written in charcoal, declares: “We are waiting for tomorrow's victory over the Taliban! Our Taliban brothers, the traitors, have sold our country to the foreigners!” Two weeks ago, the general dispatched “sleepers” to creep through the lines. He expects civil unrest in areas held by the Taliban, and predicts that the next round of American-led air strikes will destroy their army. “Then only [Osama] bin Laden will be left,” he says. “He will be alone and have nowhere to hide.”

General Manon's troops have trenches and bunkers on the crest of the chain of hills. The Taliban can be seen clearly, moving about across the valley and on the hills opposite. Whenever the 01 Brigade spot the Taliban, they loose off rounds from heavy machineguns and the Taliban reply in kind. The men of the Northern Alliance say, however, that over the past month the Taliban have been greatly weakened by desertions.

The widespread belief is that the Northern Alliance is preparing a knock-out blow concentrated in the north and aimed at linking up with troops from General Dostum's mostly Uzbek militia, which is now trying to retake Mazar-i-Sharif. If it succeeds, that will open the road to Uzbekistan, where American and British troops are deploying. Such a blow in the north might prompt many provincial leaders to defect, and might cause many of the top Taliban rulers to be deposed without fighting. After that, says one Afghan, “you will not find anyone who was a Taliban or a mullah. It is very easy to shave your beard and take off your turban.”

It is not only soldiers who are ready for the offensive. ACTED, a French aid agency, has begun distributing house-reconstruction kits to some of the 100,000 refugees who have fled to the Kalakata hills from Taliban-held territory. ACTED is doing this in the full expectation not only that a successful advance is imminent, but that refugees will return at once, even though most have lost their homes.

For the refugees, the return will not come a moment too soon. Clouds of choking dust swirl through the Lalla Guzar camp, in which families live in mud huts and tents. Rain has not fallen for three years, which means that local people are already impoverished and dependent on aid. Without the aid agencies, famine would break out within weeks. The camps also have a high incidence of bronchitis, malaria,

typhoid and meningitis.

Yet a growing sense of optimism is also palpable. The dollar has plunged in value in northern Afghanistan, not only because foreign journalists have flooded the market with the currency but, according to one money-changer, because “people think that soon there will be peace and then prices will go down.”

There are other hopeful signs in an otherwise bleak landscape. Girls go to school in the Lalla Guzar camp. In the classrooms, half the girls want to be doctors and half teachers, the only two jobs they have ever seen women doing. But some are aiming higher. “If I try I will become a minister!”, says Lalimoh, who is 12. After 22 years of war, let's hope.

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About sponsorship

Pakistan

Musharraf on the tightrope

Oct 11th 2001 | QUETTA AND ISLAMABAD
From The Economist print edition

Keeping his balance so far, despite violent disagreement on the streets

Reuters

UNLIKE the riots that broke out in several Pakistani cities against the air raids on Afghanistan, the shake-up of Pakistan's armed forces on October 7th played poorly on television. But it is probably more important. Pervez Musharraf, the country's self-appointed president, is exploiting the Afghan crisis to tighten his grip. At the same time, he is battling Islamist forces that have long acted as agents of Pakistan's foreign policy and were threatening to set the domestic agenda as well. Fundamentalists will try to use the same crisis to strike back. Rumours of a coup circulating in Pakistan this week may be baseless, but they indicate that General Musharraf's course still carries risks.

The catalyst for the army shuffle was the general's decision to side with the United States against the Taliban, whom Pakistan had nurtured since the mid-1990s. The head of the military Inter-Services Intelligence (ISI) agency, the Taliban's chief Pakistani patron, was passed over for promotion and decided to retire; other old Taliban hands at the ISI may be sidelined. Muhammad Aziz Khan, thought to be a hardline ideologue, was promoted from command of the vital army corps in Lahore into a job that will remove him from direct command of troops. General Musharraf, too exalted for further promotion, extended his own term as army chief “indefinitely”.

The beneficiaries of the shuffle are thought to be more likely than the old guard to adjust to the wrenching decision to join forces with the Taliban's enemies. But there is more to it. The newly promoted generals were celebrated in one Pakistani newspaper for their “moderate views and lifestyle”. Muhammad Yousuf, the new vice-chief of army staff, is “known as Joe to his friends and close associates”. The spin seems calculated to answer westerners' deepest fear about Pakistan: that the army could some day make common cause with the sort of people who govern Afghanistan, putting nuclear weapons into the hands of Islamic extremists.

Does the shuffle imply conciliation in other areas? General Musharraf followed it up by calling the Indian prime minister to suggest a resumption of their talks over the disputed state of Kashmir. Remarkably, he offered condolences for the deaths of more than 30 people in a terrorist attack this month in Srinagar, Kashmir's summer capital. Jaish-e-Muhammad, a Pakistan-based group that reportedly took responsibility for the Srinagar attack and then disclaimed it, has already been proscribed as a terrorist organisation by Britain and may soon be by the United States.

Pakistan has long disagreed, insisting that insurgents against Indian rule in Kashmir are indigenous “freedom fighters”. In the new climate of intolerance of terror, General Musharraf may distance himself from their crimes and even try to suppress them. “You will pretty soon find the word *jihad* disappearing from state vocabulary,” predicts Rifaat Hussain of Quaid-i-Azam University in Islamabad. But India, which warned President George Bush after the Srinagar attack that its patience with Pakistan was wearing thin, will not be easily impressed. Colin Powell, the American secretary of state, plans to visit both countries next week. He will doubtless try to breathe life into conciliation.

On the streets, though, *jihad* is gaining currency as a slogan among opponents of the air strikes. Protests have broken out across the country, the ugliest in Quetta, the capital of the vast and sparsely populated province of Baluchistan, which borders on Afghanistan and plays host to many of its refugees. There, protesters carrying pictures of Osama bin Laden and chanting “Bush is a terrorist” burned several

buildings, including the offices of UN agencies, a police station and two cinemas. On October 9th, police killed three protesters and a child near the city.

Protests have erupted also in tribal areas of North-West Frontier Province populated by Pushtuns, who belong to the same ethnic group as most of the Taliban. The leader of Pakistan's biggest religious party, Jamaat-e-Islami, has given warning that “millions” will take to the streets if the attacks in Afghanistan continue. The protests, and the din of bombs, eclipsed an anti-Taliban rally staged on October 7th in Quetta by a Pushtun nationalist party.

General Musharraf, who has dealt gingerly with fundamentalist politicians since taking power two years ago, is now cracking down. The government has arrested or confined to their homes three of the country's most vociferous fundamentalist leaders, including Fazlur Rehman, head of the Jamiat-e-Ulema Islam, which schooled many Taliban leaders at its *madrassas* in Baluchistan. Sandbagged security posts have begun to appear in Islamabad, Pakistan's well-kept capital. So far, the government is controlling the demonstrations without too much trouble, though that could change if the Afghan war drags out and gets more bloody.

Liberals hope that the government will use a showdown with the fundamentalist right to put an end to Pakistan's long flirtation with religious extremism. The shake-up in the army adds to a still-small body of evidence that this is what General Musharraf intends to do. But the price of moderation may be a uniformed president for a long time to come.

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The Islamic view

Soft words, uneasy thoughts

Oct 11th 2001 | DOHA
From The Economist print edition

Muslim foreign ministers, meeting in Qatar, tried to be reassuring

AP

How far will America go?

MEETINGS of the Organisation of the Islamic Conference have seldom roused much interest, even in the 56 Muslim countries that it represents. This one was different. The world, shocked by the carnage wrought in the name of Islam, wanted to know where the religion's leaders stood. Ordinary Muslims looked to their leaders for guidance. In the event, this week's emergency meeting of OIC foreign ministers gave comfort to both, but not as much as many would have liked.

There was almost unanimous condemnation of last month's terror attacks on the United States. There was equally strong rejection of any association between Islam and terrorism. The Taliban's call for *jihad* against America was studiously ignored. Rather than demanding a halt to American action against Afghanistan, as many of their people might have wished, the ministers pushed for assurances that the American-led campaign against terrorism would not spill over to other Muslim countries. They also set up a fund to aid the Afghan people—who, incidentally, were not represented.

All this was welcome in Washington, yet the ministers did not deliver a blank cheque to America and its allies. While broadly supporting a war against terrorism, they were also keen to define its causes and objectives. Many participants continued to demand more concrete evidence that Osama bin Laden had masterminded the September 11th attacks. More significant, most concurred with a speech by the conference's host, Sheikh Hamad al-Thani of Qatar, which stated that the roots of terrorism lie in the suppression by governments of national aspirations. The cycle of violence, he said, would never be broken without dealing with these aspirations, particularly those of Palestinians.

Muslim officials were insistent on the need for a strict definition of terrorism. The consensus was that what most Muslim countries consider to be liberation movements should be excepted. This would include groups that America, and many of its allies, brand as terrorist, including Hizbullah in Lebanon and Hamas in the Palestinian occupied territories.

The degree of solidarity on most issues seemed to surprise the participants themselves. In the past, clashes between countries such as Iran and Saudi Arabia have marred OIC meetings. This time even Iraq, a perpetual spoiler, was content to go along with the rest, although outside the meeting its language was notably harsher.

Muslim leaders genuinely feel the need to defend Islam against the negative image it is perceived to have in the West. At the same time, governments wish to present their own people with a plausible Islamic position, both to insulate themselves from American policy and to defuse popular sympathy for the Taliban, whose regime is viewed by every other Muslim government as fanatical and backward.

Their need is especially pressing just now. As America launched its bombardment of Afghanistan, television viewers across the Muslim world watched spellbound as Mr bin Laden made a rousing call for holy war. A crowd of Indonesians attacked the American embassy in Jakarta and several hundred attempted to storm parliament, a regular tactic for protesters (who often turn out in much larger numbers). Students in sleepy Muscat chanted “America is the enemy of God.” In Gaza, some quick-on-the-trigger Palestinian policemen shot dead three protesters in an ominous clash with their own people.

These protests may have engaged only a rowdy few, but they served notice that Muslim leaders face difficult choices. The hostility they feel towards the Taliban does not translate directly into helping the

campaign to crush the regime. Repugnance at the ideas of Mr bin Laden blends with fear of his persuasive powers. His methods are terrible. Some of his goals—toppling governments, igniting a clash of civilisations—are abhorrent. Yet some of his other areas of concern are widely shared.

Consider two statements. “There will be no stability, and no end to terrorism, so long as the Palestinian people are under occupation”; “America, and those who live in America, will not dream of having security before we have it in Palestine.” The first was made by the president of Cairo's Al-Azhar Islamic University, a bastion of moderate Muslim orthodoxy. The second is from the world's most wanted man. The question is whether they offer the same solution to the problem.

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Bioterrorism

The war against the spore

Oct 11th 2001
From The Economist print edition

The apparent anthrax attack in Florida would seem to represent a return to the traditional rules of terrorism

Reuters

Get article background

“ONCE is happenstance. Twice is coincidence. The third time is enemy action.” Goldfinger's warning to James Bond has taken on a new and frightening resonance for people in Boca Raton.

On October 10th, a 35-year-old employee of American Media, a tabloid publisher in the Florida town, tested positive for exposure to anthrax. She was the third case in several days. On October 5th, one employee had died from the disease. The second infection came in one of the victim's close colleagues. Neither he nor the new patient has yet developed the disease.

Officials from the Federal Bureau of Investigation and Centres for Disease Control have descended on Boca Raton, closing off the publishing house and testing almost 1,000 employees and visitors for anthrax infection. Another possible case in Virginia was quickly disproven. But the third case was revealed through these tests and hundreds have yet to be completed. After the third infection, the FBI is treating the case as a criminal investigation.

The type of disease, and the circumstances of its victims, are so unusual in America that it would have raised eyebrows even before September 11th. Anthrax is a common affliction in livestock everywhere, and it strikes people in much of the poor world. In America, however, there have been only 18 cases of this sort, known as inhalation anthrax, in 100 years, the last in the 1970s. The few who catch it tend to be those who come in close contact with animals—tannery workers who breathe in spores from contaminated hides, for instance—or laboratory workers or diners who consume infected meat.

Tabloid journalism has many occupational hazards, but anthrax is not one of them. The first victim is known to have inhaled deadly spores, also found on his computer keyboard. So how did they get there? And given that person-to-person spread of the disease is unheard of, how did his colleagues catch it? That is exactly what FBI agents and CDC epidemiologists are racing to find out. But some freak coincidence looks ever more unlikely. The strain isolated from one of the men appears to be a type more commonly found in the laboratory than in the farmyard. One suspect is the “Ames strain”, discovered at Iowa State University 50 years ago.

The FBI says it has no evidence of any connection to the September 11th attack, apparently discounting the fact that some of the terrorists stayed only a few miles away. But another possibility—of a biological “unabomber” at work—is hardly less disturbing. Arguably, finding out how the anthrax was delivered is more important than discovering who did it, since it will influence security measures elsewhere. Early reports of spores arriving in the post have largely been discounted. The investigators say there are no traces of anthrax in the surrounding area.

The State Department has ordered all American embassies to stockpile three days' supply of Ciprofloxacin, one of several antibiotics that can beat anthrax if it is detected early enough. Many individual Americans are dosing themselves with antibiotics and pestering their doctors for vaccines. Unless the outbreaks spread dramatically, such individual precautions might even be harmful. The worth of vaccines in a sudden small incident is unproven, and they may have side-effects (a few people link them to Gulf-war syndrome). There are the risks of running down supplies needlessly and, also in the case of

antibiotics, of spawning bacteria resistant to anything doctors throw at them.

David Heymann, head of infectious disease at the World Health Organisation, urges calm. More suspected cases are now likely to pop up, not necessarily because bioterrorists stalk the land, but because doctors and nurses are now reporting syndromes which they might have otherwise dismissed as, say, ill-defined pneumonia.

Indeed, this panic would surely be any bioterrorist's main objective. Limited anthrax attacks would mark a reversion to what might be called the traditional rules of terrorism. These supposedly favour killing as few people as possible, whilst frightening as many as possible. The attack on the World Trade Centre broke that rule by aiming to kill a great many people. If Boca Raton were the work of the same perpetrators, it would be a change in tactics.

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An incomplete administration

MIA

Oct 11th 2001 | WASHINGTON, DC
From The Economist print edition

Where are George Bush's lieutenants?

THIS week Tom Ridge was sworn into his job as head of a new government office of homeland security. Good. America's defences against terrorist strikes at home are scattered among many agencies and need to be pulled together. But appointing a co-ordinator will not be much good if there is no one to co-ordinate in the first place. Because of the sluggish system of nominating and approving posts, many of the key positions in the war against terrorism are unfilled.

Worried about airport security? Mr Bush has yet to nominate a deputy head of the Federal Aviation Administration. More outbreaks of anthrax? The assistant secretary of defence for health affairs has yet to be confirmed; and the director of the National Institutes of Health has yet to be nominated. And so on. Listed right are a few of the MIAs.

The unappointed
Vacant positions as of October 10th

Defence
Asst sec for health affairs (N)
Asst to the sec for nuclear, chemical and biological defence (-)
Energy
Dep administrator for defence programmes (N)
Dep administrator for defence, nuclear non-proliferation, National Nuclear Security Administration (N)
Director, Office of Civilian Radioactive Waste Management (-)
Asst sec for environment, safety and health (-)
Health and Human Services
Director, National Institutes for Health (-)
Commissioner for food and drugs (-)
Asst sec for health (-)
Justice
Director, US Marshals Service (N)
State
Special rep for nuclear non-proliferation (-)
Ambassador for int'l religious freedom (A)
Asst sec for refugees and migration (-)
Transportation
Dep administrator, Federal Aviation Administration (-)
Treasury
Asst sec for international affairs (-)
Federal Emergency Management Agency
Dep director (-)
Associate director, Preparedness, Training and Exercise Directorate (-)
Administrator, Federal Insurance and Mitigation Administration (-)

Key: (-) No action; (N) Nominated by president, not confirmed by Senate; (A) Announced by president, not confirmed by Senate
Source: Brookings Institution

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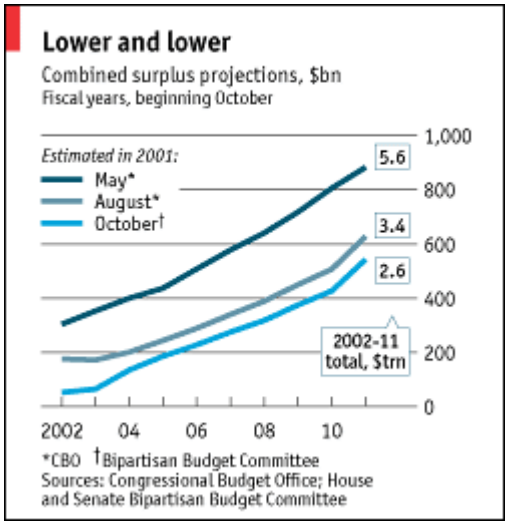
The economy

Squabbles over the stimulus

Oct 11th 2001 | WASHINGTON, DC
From The Economist print edition

Do George Bush's ideas for boosting the economy make sense?

AMERICA'S fiscal stimulus package is being billed as an appropriate response to an extraordinary economic shock. But it is beginning to look much like any other Washington budget battle. Conservative and liberal partisans are both crying foul; the White House is using fuzzy numbers; business lobbyists are swarming to push their pet provisions; and economists cannot agree about whether the whole endeavour makes sense.



After weeks of silence, the Bush administration laid out its wish list last week. It wants an additional stimulus (on top of the $45 billion disaster spending and airline bail-outs already announced) of up to $75 billion, focused primarily on tax cuts. Add in the tax cuts already slated for 2002 and the total fiscal boost next year could reach $150 billion-180 billion, or just under 2% of GDP (only slightly smaller than the Reagan tax cuts).

George Bush wants to spend around $15 billion helping the unemployed. The rest of his stimulus is to be divided between four main tax cuts. Two are to boost consumption. Mr Bush wants a one-time tax rebate for poorer Americans who pay taxes but who didn't earn enough to get a full rebate earlier this year. He also wants to accelerate some (or all) of the cuts in marginal income-tax rates already slated for 2004 and, possibly, those due in 2006.

To help businesses, the White House proposes abolishing the corporate alternative minimum tax. This tax, which affects a tiny fraction of companies, is designed to ensure that firms do not avoid paying taxes by claiming excessive deductions. Lastly, Mr Bush wants to introduce some permanent incentives to boost investment. One possibility is to extend from two to five years the period over which firms can count today's losses against earlier tax liabilities. Another option is to allow businesses to write off their investments more quickly, perhaps through a permanent loosening of the rules for expenses.

The focus on tax cuts was designed, in large part, to appease conservative Republicans, a group Mr Bush has long mollycoddled. They were getting increasingly angry about his bipartisan cosying with Democrats, his concern at limiting the size of the stimulus and his willingness to spend. Last week, several Republican tax-cut groups accused Mr Bush of sounding like a former Democratic treasury secretary, Robert Rubin—presumably a huge insult.

Yet Mr Bush hasn't fully pleased the right. His proposal ignores two Republican obsessions—a reduction in capital-gains taxes and a cut in the corporate income-tax rate (the latter was even strongly supported by plenty of Mr Bush's own officials). The president, complains one lobbyist, Mark Bloomfield, “made the political calculation that bipartisanship was more important than the concern about holding on to the conservative base.”

At the same time, Mr Bush's ideas have brought scathing criticism from the left. Democratic number-crunchers point out that most of these cuts are poorly crafted to stimulate the economy now. The income-tax cuts, they say, will mainly benefit richer Americans, who are more likely to save their extra income.

In Mr Bush's favour, consumers tend to adjust their spending more in response to a permanent, rather than a temporary, tax change. Precisely the opposite, however, seems to work with corporate

investment, which responds more powerfully in the short term to temporary tax incentives. That suggests Mr Bush's permanent corporate-tax changes may get little bang for his buck.

And the Bush White House is once again playing games with numbers. The $75 billion price-tag for the stimulus refers only to fiscal 2002. Since several of its provisions are permanent, the overall fiscal cost will be higher. Analysts at the Centre for Budget and Policy Priorities reckon, for instance, that the ultimate cost of accelerating income-tax cuts from 2006 to 2002 will be around $120 billion. Congress's bipartisan joint tax committee reckons the tax cut alone will cost $90 billion—120 billion in 2002. Given the scarcity of details, it is hard to quantify the cost of the whole tax package precisely, but it could be up to $300 billion over ten years—a tad more than Mr Bush's $75 billion figure.

The big argument is how such numbers would affect long-term interest rates. This is largely because Alan Greenspan, the chairman of the Federal Reserve, has framed the stimulus debate in this way. Mr Bush himself has talked of a stimulus package “big enough to get the economy moving in the short run, but small enough so it doesn't affect long-term interest rates.”

The problem is that economists are not agreed on whether that effect exists, let alone how big it is. In a widely cited paper from 1986, Martin Feldstein of Harvard University argues that the impact can be huge. He suggests that each percentage point increase in the five-year ratio of budget deficits to GNP raises the long-term government bond rate by approximately 1.2 percentage points. But many studies find no compelling evidence linking the two variables. It is very hard to measure the effect of deficits on interest rates because so many other factors can affect real rates. On balance, most economists believe there is an impact, albeit a pretty small one.

Ironically, the stimulus package will matter much less to America's long-term health than another fiscal development: the deterioration in government finances that has already taken place. The combination of a slower economy, higher spending and (primarily) the original Bush tax cut has slashed projected future surpluses (see chart). In May, the Congressional Budget Office forecast a surplus of $5.6 trillion over the next ten years (4.1% of GDP). That shrank in August to $3.4 trillion. Now the House and Senate budget committees have given a new estimate of $2.6 trillion (2% of GDP). This is based on a short downturn and includes the anti-terrorism spending and airline bail-outs. Their worst-case scenario reduces the cumulative surplus to a mere $270 billion. And none of these numbers takes account of another estimated $1.2 trillion in extra spending and tax cuts that might still happen (see article).

This fiscal shift is truly massive. It argues not only against a stimulus package with big long-term costs, but also, perhaps, against permanent tax cuts. One reason why business and conservatives are lobbying so hard for big cuts now is because they know that it may be the last time any president can cut taxes for a while.

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Farm policy

Just plant dollars

Oct 11th 2001 | MINNEAPOLIS
From The Economist print edition

They grow without the farmer having to do anything

ONE of the glories of American farm policy is that, whenever you think it cannot get any loonier, it promptly finds a way of doing so. After pumping some $70 billion of public money into farms over the past four years, and thereby stimulating even more over-production of food, the House of Representatives has now passed a farm bill approving the payment of $173 billion over the next ten years (roughly $70 billion more than had been budgeted for).

Back in 1996, the Republican Congress bravely sought to end government support of agriculture. The Freedom to Farm Act largely eschewed the policy of supporting crop prices; instead, it set a schedule of fixed payments to farmers, depending on their acreage, these payments gradually declining to zero over seven years. In exchange, the farmers were allowed to plant what they wanted.

This dose of semi-market discipline worked well in 1997. But in 1998 prices for grain and many staple farm products plummeted. Alas, farmers had already planted too many of the “profitable” crops, creating huge surpluses and sending prices even lower. The government had to intervene with “emergency payments” and “temporary” price supports. Last year, a record $28 billion was doled out. Roughly half of all subsidies went to the big-acre potentates who are only 8% of the total number of farmers.

For most congressmen, the lesson to be drawn seemed pretty obvious: since the government is not going to stop supporting agriculture any time soon, why not win votes from farmers by adding even more money now? The new bill introduces formal price supports for farmers when crop prices fall too far. It also includes new payments for grain, soya and cotton producers in the farming states of the Great Plains and Texas.

The American Farm Bureau has duly hailed the vote as a much-needed stimulus for moribund rural America. The Bush administration is furious about both the timing (surely there were more urgent things for the House to think about?) and the fact that the new money will stimulate even more overproduction, thus driving prices even lower and bringing more pleas for help. It will also harm world-trade talks, by bringing protests that rich America is driving poor countries' farmers to the wall.

The matter now moves to the Senate, which is likely to be less generous (though the talk is only of limiting subsidies, not eliminating them). Tom Harkin, the Democratic chairman of the Senate's agriculture committee, may call for the Senate to produce its own farm bill this year. The Bush administration and Richard Lugar of Indiana, the committee's senior Republican, are playing for time, pointing out that the 1996 bill does not expire until next year. Maybe, they hint, the Senate should delay its decision until the budget picture—and, by implication, the minds of politicians—have had time to get a little clearer.

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About sponsorship

Airports

Go on expecting delays

Oct 11th 2001 | LOS ANGELES
From The Economist print edition

If airports feel lonely places right now, they probably won't stay that way

AP

El Toro was used to congestion

BEFORE September 11th, the best way to provoke a fight in Orange County was to mention El Toro. There had long been talk of converting the former marine base into a civilian airport. People who live around the base hate the idea. A lot of business folk are in favour of it. The drop in air travel since the terrorist attack has briefly calmed things, but America's airport problem has not gone away.

Southern California shows why. An area with an economy almost as large as Brazil's has only one big international airport—Los Angeles International, LAX on your tickets. Last year LAX coped with 68m of the 105m tourists and business travellers who flew to and from the region. It is the third-busiest passenger airport in the world, and the third-largest cargo airport, handling 2m tonnes of freight a year.

LAX was designed in the 1950s to handle just 40m passengers a year. As it has strained at its seams, delays—and dangers—have increased. Last year it had the third-worst punctuality in the country, and for the past four years it has had more near-misses between aeroplanes manoeuvring on the ground than any other large airport.

On top of late flights, the biggest delay for most Californians is getting to the airport in the first place. Part of the problem is that airlines fly to where most passengers are, and travellers fly from the airports that offer the widest choice of flights. This creates a tendency for traffic to cluster at one airport.

Southern California's cramped, elderly airports occupy a total of only 8,400 acres, barely half what is available at Dallas-Fort Worth and a quarter of the space at Denver International. Even if you could fully use all the runways at southern California's smaller airports (which would mean forcing people to fly from remote spots), the system could still handle only 140m passengers a year. Unfortunately, a study by Steven Erie, a political scientist at the University of California in San Diego, suggests that demand in the region will rise to 196m a year by 2025.

For Orange County, the problem is particularly acute. The county has one small airport, John Wayne, which catered to 7.8m passengers last year, so most of its business passengers struggled along clogged motorways in order to use LAX. El Toro, according to the people who want to convert the marine base, could become a commercial airport capable of handling 28m passengers a year.

Former military airfields have been turned into successful airports in Orlando, Florida, and Austin, Texas. But people who live near El Toro have used a wide range of tactics, ranging from environmental challenges to ballot initiatives, to oppose its conversion. At the same time, people around LAX have spent the past six years fighting a $12 billion “master plan” to expand the airport's capacity to 89m by adding a new terminal and new access roads. The plan would also try to steer traffic to Ontario and Palmdale, two smaller airports owned by the city of Los Angeles (and both over 40 miles from the city).

Back from the brink?

On the face of it, September 11th has handed victory to the anti-expansion people. On October 8th James Hahn, the new mayor of Los Angeles, proposed a new plan for LAX, arguing that the drop in travel makes a new terminal unnecessary and that most of the money should instead be spent on security. Decisions and votes on El Toro have been postponed (as have fiercely-argued-about expansion projects at airports in Minneapolis, San Francisco and Houston).

This looks short-sighted. Traffic has begun to pick up markedly in the past week or so. Mr Erie sticks by his pre-September 11th numbers, arguing that continuing growth in the region's tourism, high-tech manufacturing and trade will push passenger totals back towards his figure within the next few years. Some predictions for nationwide traffic talk about a mere 1% fall this year from last year's total of around 700m passengers; some say it could reach more than a billion by 2012.

Even if growth disappears completely, few business people were exactly happy with the status quo. Delays already supposedly cost American businesses $6 billion a year, partly because so few new runways have been built. In the past decade, demand for air travel in America grew by 37%, while airport capacity across the country grew by only 1%.

Similarly, even if traffic stops growing, many of the new security measures will make congestion worse. Bags will take longer to check. Car parks are now banned within 300 feet of a terminal. The layout may become more cluttered. Evan Futterman, chairman of aviation services at HNTB, a civil-engineering firm in Alexandria, Virginia, says that several airports had been planning to shrink their ticketing halls by moving all the shops and restaurants beyond the security barriers. Now that these will be out of reach for people without tickets, he thinks, the temptation will be to do the opposite.

At LAX the new security regime is already giving travellers a taste of delays to come. A ban on private cars means that passengers have to be dropped off and picked up at a remote carpark, from which buses shuttle them to the terminals. Soldiers of the National Guard, who have been posted at LAX and San Francisco International airport since October 5th and are due at California's other airports within a few weeks, add to the jam at security gates without obviously tightening the screening process. With travel already approaching normal levels, southern Californians may soon find themselves once again losing their cool over the future of airports—and El Toro.

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The races in Virginia and New Jersey

Will anything be the same again?

Oct 11th 2001 | RICHMOND
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Yes, the Democrats will probably still win

AP

Schundler trundles behind

WRAPPING yourself in the flag is hardly a new campaign technique. But seldom has it seemed so like the only one. In New Jersey and Virginia, the two states choosing governors this year, Old Glory is ubiquitous, turning up in television commercials, on bumper stickers and on the lapels of the candidates' otherwise muted pinstripes. So far, it is a game that the Democrats are playing better.

With the elections due on November 6th, the voters should have been the target of a maelstrom of advertisements. Instead, the campaigns have an abbreviated feel. Gone are debates over local property taxes, education reform and stressed state budgets. In their stead are appeals to bipartisanship, sombre discussions about economic uncertainty and law and order, and, of course, the flag.

On the face of it, defence and crime are Republican themes. Yet in both Virginia and New Jersey the Democratic candidates have held on to leads established before September 11th. This may be just because nobody is paying much attention. But, as Larry Sabato of the University of Virginia points out, patriotism needs to be subtle: there are great risks in “appearing to be using tragedy as campaign fodder”.

The man who may have misplayed his hand is one of the more interesting candidates: Bret Schundler, the Republican candidate in New Jersey. Stranded overseas on the day of the attack, Mr Schundler seemed to criticise New Jersey's officials for not reacting properly to the attacks on the World Trade Centre, which killed hundreds of Jersey commuters.

What Mr Schundler actually said is in dispute between his staff and the *New York Times*. But New Jersey's interim governor, Donald DiFrancesco, who is also a Republican, and most of the local party establishment were furious. And James McGreevey, a Democrat who was well ahead in the polls even before September 11th, promptly went out of his way to praise Mr DiFrancesco.

Mr Schundler has apologised for any misunderstanding, insisting that he was merely trying to argue that the New Jersey militia and the state's police force needed more training and equipment to deal with terrorism. But the episode has deflated a conservative candidate who had been bubbling with ideas on education and government reform.

Mr McGreevey, by contrast, has stuck to the bipartisan script relentlessly. The mayor of Woodbridge has called for the creation of an anti-terrorism unit within the state police, an agency the Democrats were until recently accusing of racial unfairness. And he has run TV ads in which, framed by the American flag, he exhorts voters to unite behind the president.

New Jersey might be expected to go to the Democrats: Al Gore won there in last year's presidential race by 16 percentage points. But George Bush won in Virginia, and Republicans hold all the statewide offices. Surely they cannot fail there too?

In fact, their nominee, Mark Earley, had been finding the going rough before September 11th, hampered by a series of local Republican squabbles and scandals, not to mention his own hyper-conservatism. For Mr Earley, a former attorney-general, the terrorist strikes were a chance to show his political experience. His Democratic opponent, Mark Warner, a technology tycoon, has never held elective office. An Earley

television advertisement showed two of his six children raising the flag outside their home and the candidate strolling with three local Republican bigwigs, Governor Jim Gilmore and Senators John Warner and George Allen, whom he had earlier preferred not to mention.

This seemed innocent enough, but another Earley ad claimed that Mr Warner was in favour of higher taxes. The Democrat says this is no truer of him than of Mr Earley. They both favour a referendum on whether to raise the sales tax for transport improvements, though Mr Earley now says he would hold up a tax rise until the economy perks up. Mr Warner, who shares an advertising consultant with Mr McGreevey, has fired back with ads first “correcting” Mr Earley's charge and then accusing him of conduct unbecoming a candidate—trying to separate the parties when events should bring them together.

Like Mr McGreevey, Mr Warner has sought to look as bipartisan as possible. His ads have expressed his solidarity with Mr Bush, and picked up the president's campaign talk about being “a uniter, not a divider”. From his flag-bedecked set, Mr Warner talks of the “special responsibility to run a campaign that unites us, not divides us.”

The Democrats' new-found admiration for Mr Bush is galling for Republicans. But they can hardly criticise their opponents for loyalty to the president. The race will surely narrow, but the advantage for the moment is with the Democrats.

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Herblock: grit in the oyster

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THE cartoons of Herblock peered into a third of America's history. The Washington Post's cartoonist, who died this week, drew every president since Herbert Hoover. Two—Richard Nixon and Dwight Eisenhower—reputedly refused to see the Post for fear of his work. Most of his targets were on the right (he invented the term McCarthyism), but he attacked hypocrisy everywhere. “True, I had coffee with those big contributors,” Bill Clinton was shown saying. “But I didn't swallow.”

Along with Oliphant and Conrad, who are both still drawing, Herbert Block was part of a cartoon triumvirate whose work has looked increasingly passionate compared with the tepid “op-ed” prose that surrounds them. Now, in America's newspapers, political cartoons are giving way to pictures. More's the pity. As Herblock once asked, “Where would the pearl industry be without irritating ingredients?”

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Lexington

Old hawk learns new tricks

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The "first war of the 21st century" enlists a new Donald Rumsfeld

DURING the summer, one of Washington's favourite parlour games was to wonder who would be the first member of the Bush cabinet to be sacked: Paul O'Neill, the man in charge of the Treasury, or Donald Rumsfeld, the defence secretary? Both were veterans in the administration's band of "grown-ups"—former corporate executives with experience in politics dating back to the Ford administration. And both of these old men, in dealing with the people whose backing they needed, seemed to exhibit contrasting defects of advanced age: the overly garrulous Mr O'Neill frightened the markets, the overly secretive Mr Rumsfeld alienated the generals. On September 8th, the *New York Times* opined that Mr Rumsfeld had "cratered at the Pentagon".

Whatever happens to Mr O'Neill, Mr Rumsfeld is plainly out of the running for early re-retirement. From the moment on the morning of September 11th when he dashed out of his office to join the rescue work in the wrecked part of the Pentagon, the defence secretary has been one of the three or four indispensable figures of the administration. His behaviour that morning was undoubtedly brave, comparable in some ways to Margaret Thatcher's decision in 1984 to go ahead with a speech to her party only hours after a terrorist bomb had narrowly failed to kill her. It was also a defining moment in what had been a rocky relationship between Mr Rumsfeld and most of the Pentagon's brass. He had done what soldiers have to do: stand fast when the world explodes around you. He had led by example.

Of course, in any war you would expect a defence secretary to do things that catch the eye. And in Mr Rumsfeld's case this war has removed an immediate cause of embarrassment. The main earlier criticism of him had been that he had failed to make a convincing case to the Pentagon, let alone to Congress, in favour of his ambitious plans for military reform.

Decisions will in the end be taken about those plans, and what happens in this war will help to shape those decisions—not least his belief that America's armed forces should move away from the lumbering tank divisions needed to protect cold-war Europe in favour of smaller, faster-moving, missile-punching units. For the moment, though, America is fighting, not having a debate about strategy. Long-term questions can be shelved. Moreover, the Defence Department is likely to be showered with so much money over the next few years that Mr Rumsfeld will be able to buy off his critics. Instead of having to make a choice between this new missile or that old tank, the Pentagon will doubtless get both.

But Mr Rumsfeld's rescued reputation is not merely a result of standing by his post, and dodging an awkward argument. A man with a job like his needs two connected qualities: an ability to inspire confidence, and the capacity to focus on the task in hand without getting bogged down in distractions. Mr Rumsfeld has met both tests.

The generals' new admiration for him may come from that moment at the Pentagon on September 11th. But the approval felt by so many ordinary Americans also comes from something else: a reassuring, plain-speaking calmness that does not exaggerate successes or brush aside the dangers that still exist. In the Gulf war, many Americans felt irritated by inflated claims of military efficiency, such as the likely success of Patriot anti-aircraft missiles. Mr Rumsfeld has refused to exaggerate either the impact of the first strikes on Afghanistan (admitting, for example, that the Taliban could still have the ability to fire at American aircraft) or the impact of the strikes themselves (constantly insisting on the limitations of

military action).

Arguably, he is just trying to “spin” the war. But there seems more to it than that. Spinners blur and dodge. Mr Rumsfeld's waffle quotient is remarkably low: he either speaks straightforwardly, or not at all. Faced with hard questions, he does not talk about what he does not know. That is a change in loquacious Washington. It is also a reassurance that, when he does go into details, he knows what he is talking about. And he has been honest, as it were, about lying in the interest of national security, quoting Winston Churchill's dictum that “in wartime, truth is so precious that she should always be attended by a bodyguard of lies”—before saying that he does not intend to tell lies. Well, we have been warned.

Above all, he has played a vital role in creating a consensus about how the war should be fought. Before September 11th, and for a few days after it, the Bush administration had seemed to be divided between unilateralist, ultimatum-wielding hawks and multilateralist, negotiating doves. Mr Rumsfeld was a leading hawk. But during the first days of the war this changed. He and Colin Powell, secretary of state and leading dove, have taken more or less the same position: America's first targets are Osama bin Laden and the Taliban, and to deal with them it has to assemble a large coalition of allies.

The result is that, for the moment, the administration is standing shoulder-to-shoulder. Mr Rumsfeld has at least temporarily silenced the principal voice arguing for a different strategy, his own deputy, Paul Wolfowitz. Little has been heard recently of Mr Wolfowitz's belief that global terrorism cannot be stamped out without overthrowing Iraq's Saddam Hussein, though that idea has not entirely vanished. Mr Rumsfeld—who only a few weeks ago was struggling with the politics of his job—also seems to be the prime shaper of the modern, flexible sort of alliance that America is trying to assemble. This is not a single, rigid entity; it is a collection of several interlinked alliances, in which different countries contribute different things to different operations. This makes it possible, at least in theory, for the war to move forward, step by step, without the need for everybody to agree about everything all the time.

Far from being inflexible, the old hawk is coping with the demands of 21st-century warfare pretty well.

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Argentina's congressional elections

The end of the Alliance?

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The voters are set to give the Alliance government of President Fernando de la Rua (below, right, with Domingo Cavallo) a drubbing—before it breaks apart anyway

EPA

WHO'D be President Fernando de la Rua or a member of his Alliance government? The Alliance—a joint-venture of the old Radical party and the younger, further left, Frepaso—can expect a drubbing in the mid-term elections on October 14th. The result may be the creation of a much-mooted "government of national unity" designed to steer Argentina out of its three-year recession. Yet it was a groundswell of national disgust with the later sordid years of rule by President Carlos Menem and his Peronists that brought the Alliance and Mr de la Rua to power, and here they would be, forced to share it with their enemies.

Something more important than the Alliance could suffer too. In some districts, say opinion polls, as many as 25% of the voters intend to spoil their ballots (voting is compulsory). That is as big a share as the polls credit to the leading candidates in the city or the province of Buenos Aires, which together account for nearly half the country's population. This, the Alliance argues, proves that Argentines are sick of all politicians, not just the current government. That's a comfort, isn't it?

Still, democracy could see one good result. Besides replacing half the Chamber of Deputies, voters will elect a completely new Senate (for the first and last time: until now its members were elected by provincial assemblies; in future it will be renewed a third at a time, with elections every two years). That should give fresh legitimacy to a body widely discredited by allegations of padded payrolls and bribe-taking since Mr de la Rua took office: 11 senators were accused last year of taking money to vote for government-sponsored labour reforms.

But that will be no relief to the Alliance. Though the Peronists, now by far the largest element of the Senate, may actually lose some seats there, they will retain control. Unless the pollsters are badly wrong, when the new Congress meets on December 10th, the Alliance will be outnumbered by the Peronists in both houses. By then the four-year-old coalition is in any case likely to have expired: the remaining members of Frepaso, the smaller partner in government, look ready to walk out.

Indeed, as Mr de la Rua's government plumbs unparalleled levels of unpopularity, it is hard to find even candidates from his own Radical Party openly offering support. Raul Alfonsin, a former president now running a poor second as the Alliance's candidate in Buenos Aires province, has spent most of the last two years sniping from the sidelines. Rodolfo Terragno, another Radical, leads the Senate race in the capital after turning his campaign into a crusade against the current economy minister, Domingo Cavallo.

The awfulness of Mr Cavallo is the one point most candidates agree on. Last week, the president twice had to back his besieged minister publicly amid rumours of impending devaluation. But, though Mr Cavallo's own small party will be another loser at the

polls, he may retain his current post for a while longer. For one thing, there is no credible replacement willing to grasp the poisoned chalice. For another, many opposition leaders are less virulently hostile to Mr Cavallo and his economic policies than are the bulk of the Alliance. “The Peronist governors in the large provinces will make only formal criticism,” says Ricardo Rouvier, a pollster. “The strategy is to let the government collapse by itself.”

The woes of the economy are such that the Peronists, for now, are happy to have someone else handle them. After external credit had dried up, the government in July declared that it would at once eliminate its fiscal deficit. But the ensuing spending cuts have further slowed activity, hitting tax revenues, which slumped 14% last month. Since there seems to be little alternative other than full-scale disaster, the opposition has hinted that it may accept cutting transfers to the provinces, to help balance the budget.

The optimists' theory is that, if the politicians can stick to the zero-deficit policy at least until year-end, the IMF and the American Treasury will be persuaded to improve on the $8 billion in loans that they promised in August. That would help to finance a voluntary debt rescheduling. Eventually, confidence would be restored and with it economic growth. But whether that happens or not, the Peronists are unlikely to stay quiet for long.

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South American trade

Sticking-plaster for Mercosur

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Brazil and Argentina have patched up their row over trade and the *real*

RELATIONS between Brazil and Argentina, the two biggest members of Mercosur, the South American trade block, have been stormy recently. Argentina's economy minister, Domingo Cavallo, has accused Brazil of upsetting trade by deliberately devaluing—the *real* is down about 30% so far this year—and even of betting on the collapse of Argentina's currency-board system, which pegs its peso. In reply, President Fernando Henrique Cardoso has called the comments "beyond the limit", and Brazil has threatened to retaliate against Argentina's suspension of some of Mercosur's common import tariffs.

But—as several times since Brazil's forced devaluation of 1999—the neighbours have avoided a row becoming a rupture. A hastily arranged visit by President Fernando de la Rua to Mr Cardoso on October 8th, followed by meetings of their foreign and finance ministers, ended in a joint affirmation: both countries want to maintain Mercosur as a customs union (translation: Argentina has abandoned its talk of ignoring the agreed tariff rates altogether) and will go on negotiating side-by-side in Mercosur's talks with America and the EU. And, one distant day, they will go for monetary union.

Argentina also softened its claims for compensation for the damage it says it has suffered from Brazil's devaluation. Brazil agreed instead to discuss letting Argentina impose "safeguards"—probably tariffs—on any products that it can show to have been affected by a surge in imports caused by the plunging *real*. Not just any safeguards, though: they must be "inspired by the rules of the World Trade Organisation"—ie, temporary, and the Argentine companies thus protected must restructure.

Until now, Brazil had said no to any formal safeguards, though it had encouraged its exporters not to push too hard into Argentina. Even that concession might be thought more than enough: vigorous Brazilian growth, combined with Argentina's recent but long-lasting recession, has meant a trade balance in Argentina's favour since Mercosur got into full swing in the mid-1990s—a change from earlier days which the Brazilians have used to persuade the Argentines that they are better off inside Mercosur than out. Mr Cavallo may remain sceptical, but he has called off hostilities, perhaps because his standing at home is no longer what it was.

The two countries' recent rows over Mercosur have given markets yet another reason to be nervous about them. So it is as well that both have realised that the alternative to hanging together is hanging separately. Even so, worries remain: if the *real* falls further, Argentina may be on the warpath again and, even if not, "temporary" safeguards are apt to endure.

And the whole Mercosur concept? The block—Paraguay and Uruguay are its small members, Bolivia and Chile associates—has survived several crises. But it is still far from deepening and broadening into the South American single market that it aspires to be. Even now, traders face many minor barriers, such as petty bureaucracy and inconsistent regulations. Goodwill and continuous effort (rather than hasty crisis management) could get rid of these. But the real trouble is the one patched over this week: the biggest member has a fully floating—ie, sinking—currency, and the second-biggest has one tied to the dollar.

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Colombia's peace process

Still breathing

Oct 11th 2001 | BOGOTA
From The Economist print edition

A new deal with the FARC guerrillas may bring a six-month ceasefire

YET another last-minute kiss-of-life for Colombia's frail peace process: President Andres Pastrana on Sunday announced a deal with the FARC guerrillas. They will get a further period, till January 20th, of untroubled control of the "demilitarised" enclave that they run in the south; and fresh talks will start at once, intended to bring, at least, a six-month ceasefire.

Mr Pastrana had been under pressure to get tough after the FARC murdered Consuelo Araujo, a popular ex-minister of culture. She had been seized at a FARC roadblock, and on September 29th was found shot dead. But the guerrillas also agreed to give up this habit of "miraculous fishing"—stopping all vehicles and grabbing the cream of their occupants as hostages—and the president persuaded doubters to give the peace process one more chance.

A similar last-minute deal in January, after an alleged FARC deserter hijacked an aircraft with 30 people on board, in the end bore little fruit. But the new one might just work. A presidential election is due next summer, and all the candidates talk of taking a much tougher line towards the FARC than Mr Pastrana has. One of them, indeed, Alvaro Uribe Velez, a right-wing dissident from the opposition Liberal Party, says that, unless a ceasefire were in force at the time, he would set about retaking the FARC's enclave from the day of his inauguration. His opinion-poll ratings have soared. The rebels do not want him in power, and they know that further violence would make that likelier. A six-month ceasefire declared on or around January 20th would conveniently cover the election campaign and the second round of voting on June 16th.

The guerrillas are no fools politically. Between the two rounds of presidential voting in 1998, Manuel Marulanda, their leader, agreed to meet Mr Pastrana, as a first step towards substantive peace talks. This was one big reason for Mr Pastrana's victory. Now again the FARC can hope to influence the choice of a new president.

That is, so long as the rebels' sworn enemies, the right-wing paramilitaries, do not succeed in their aim of scuppering the peace process unless they themselves are also included in it. They have just murdered a left-wing congressman, and frightened into exile two members of the three-man commission that drafted the new accord. And in one strike this week they added 17 villagers to their toll.

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Mexico and the United States

Let us be your frontier post

Oct 11th 2001 | MEXICO CITY
From The Economist print edition

President Vicente Fox offers to help stop terrorists sneaking north from Mexico

IT USED, or so it thought, to top the bill on George Bush's foreign-policy agenda. Alas for Mexico, on September 11th it became a sideshow. Hopes of a deal on migration have faded, victims of American jitters about any unchecked influx of foreigners. New security controls have made the cross-border roads more like giant parking lots. Is Vicente Fox dismayed? That is not his way: the Mexican president has come up with a plan to restore relations—a trilateral security zone that would make Mexico and Canada the first line of defence of America's borders.

With 300m crossings of the Mexico-United States border each year, a determined terrorist will always get through, say Mr Fox's aides. Far better to catch him in Mexico, and in Washington last week Mr Fox offered unprecedented help in doing so. After the attack, Mexico held and questioned hundreds of people of Middle Eastern origin, in an American-directed manhunt. Now, says Mr Fox, let's extend that co-operation, with immigration and customs agencies in the three countries passing each other intelligence on the movements of potential terrorists. Mexico would also keep a closer eye than now on the people-smugglers. Most of the people concerned are poor would-be workers from Central America and Mexico. But the smugglers are increasingly being used by a wider range of the world's migrants—Chinese, Indians, Iraqis and others.

Mexican help against illegal migrants would certainly help the United States. But Mr Fox's aim is to help Mexico too. If his plan makes the Americans feel safer, they may ease their new controls on legal crossings. “We want to discuss how to increase security on the border without making it a bottleneck,” says Adolfo Aguilar Zinser, head of Mexico's National Security Council. And, he might have added, make the United States, obsessed with its own security, notice that Mexico is still there.

The proposal also marks a change within Mexico. Traditionally, it has held itself at arm's length from its mighty neighbour's foreign-policy goals. And though the foreign minister, Jorge Castañeda, gave swift backing to the American war on terror, opinion polls showed ordinary Mexicans wanted to remain neutral in any conflict. After some discord in his cabinet, Mr Fox decided to go to Washington and show that he does not. “The terrorist attacks of September 11th were an attack on humanity and therefore an attack on the national interests, peace and aspirations of all Mexicans,” he told his countrymen in a television broadcast after the first bombs hit Afghanistan.

But will the Americans respond? Since taking office last year, Mr Fox has promised to clean up the corruption that greases so much in Mexico, from people-smuggling to drug-trafficking—but, so far, to little effect. American officials say they are eager to help boost Mexico's border controls, but cannot see their country trusting its security to foreign border officials who, for $50, will look the other way while some dubious character comes in. “We'd all like things to get back to normal as soon as possible,” says an American official. “But the way we think about our borders is a lot different from what it was a few weeks ago.”

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Canada and the war on terrorism

A new face to the fore

Oct 11th 2001 | OTTAWA
From The Economist print edition

Canada will send troops. Its foreign minister may go further still

AP

No dove, Manley

CANADA has been under fire for its slow reaction to the events of September 11th, and its tepid response to the American call to arms. When 300 politicians from NATO countries met in Ottawa on October 6th, a British member of parliament named it as one of the “passenger countries” in NATO. Within 24 hours, the prime minister, Jean Chrétien, announced that six warships, surveillance aircraft and 2,000 servicemen were on their way, including a counter-terrorism unit, which is expected to operate on the ground alongside American and British troops.

Yet the critics have had a point. Although ordinary Canadians in huge numbers gathered on Parliament Hill to grieve for the victims of the atrocities of September 11th, and have deluged the American embassy with flowers, Mr Chrétien called no full cabinet meeting to discuss the crisis until October 10th, and was slow to visit the ruins in New York. Canada was behind the United States “every step of the way”, he had said. Just how far behind, some newspaper columnists began to wonder?

His caution was typical of Mr Chrétien, now in his third term. He usually waits to gauge the public mood before acting, and has often shown himself wary of the American steamroller. Nor was he alone: his former foreign minister, Lloyd Axworthy, who resigned a year ago, argued in the press on September 17th that “only if there is a *bona fide* international mandate and a clear, culpable target, should Canada join in any military action.” It took the dossier on Osama bin Laden's network to persuade the prime minister to act.

Step up—and it may not be the highest he will go—John Manley, the current foreign minister. Till now he had been seen as a colourless, bookish tax lawyer, excited —as industry minister—only by things like fibre optics and space technology. But with incisive and relatively hawkish comment he filled a void left by the prudent Mr Chrétien and the defence minister, Art Eggleton, once (and more impressively) the mayor of Toronto. Already head of a cabinet anti-terrorism committee, Mr Manley spoke publicly on October 4th of Canada's “glaring inadequacy” in spending on defence and intelligence-gathering.

He has felt confident enough to answer the repeated American call for a perimeter wall of harmonised immigration and refugee regulations around North America with the remark that he finds such talk simplistic. Fine, he said, let's solve the security problems of border controls, which have slowed trade. But talk of a perimeter wall was code for continental integration.

How far will all this lead? George Robertson, NATO's secretary-general, called Canada a stalwart ally after its pledge of ships and aircraft—and then asked for still more Canadian troops, to peacekeep in the Balkans in place of American troops who may be sent farther east. As for Mr Manley, who can tell? Next summer Canada is due to play host to the G8 summit—an arena in which Mr Chrétien's heir-apparent, the finance minister, Paul Martin, is accustomed to shine. But Mr Manley had his own angle on the G8 too: “You can't just sit at the G8 table and then, when the bill comes, go to the washroom.” At 51 a dozen years younger than Mr Martin, he is now seen as a credible contender for the leadership.

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China and America

Friends again, for now

Oct 11th 2001 | BEIJING
From The Economist print edition

The terrorist attack on America has brought warmth to relations with China

Get article background

RELATIONS between China and America are notoriously volatile, but rarely have they veered so swiftly from enmity to seeming friendship as in the past six months. When George Bush visits Shanghai next week—unless he decides he is needed elsewhere, that is—he will find a country doing its utmost to play down old differences and highlight a new spirit of co-operation in the fight against terrorism. But optimists may well be disappointed when the dust begins to settle.

Mr Bush has already said he will be too busy to extend his visit to Beijing after the Shanghai gathering of leaders from the Asia-Pacific Economic Co-operation forum, APEC. His visits to Japan and South Korea have been scrapped. But China is delighted enough to be playing host to Mr Bush for the first time since he became president. Nineteen other heads of government are also expected in Shanghai, including Vladimir Putin of Russia, Japan's prime minister, Junichiro Koizumi, President Megawati Sukarnoputri of Indonesia and Australia's prime minister, John Howard. It should be the biggest gathering of world leaders in China since the Communist takeover in 1949. China does not want any bilateral tensions to spoil it.

Will China and America pay less heed to their disputes?

The optimists' view is that China and America, now united by a common enemy in the form of terrorism, will pay less heed to their long list of disputes. These range from disagreements over human rights, through tension over China's perennially huge trade surplus with America (though China's imminent accession to the World Trade Organisation will help here) to what is in effect a cold war over Taiwan. In April, a collision between an American surveillance plane and a Chinese fighter off the Chinese coast caused the worst rupture in years. Mr Bush's offer of a big arms sale to Taiwan later that month exacerbated tensions.

By the time of the September 11th attacks in America, the two sides were already back on relatively friendly terms. But now China is going further. It is quietly endorsing an American military strike against one of China's own neighbours—albeit hardly a very friendly one—and expressing sympathy with America's plight. It has also ordered its media to avoid expressing delight in America's misfortune, although China's less controllable Internet users have posted many messages on state-approved bulletin boards suggesting that America deserved it.

Unlike Russia, China has relatively little to offer in the fight against terrorism

China and America have co-operated over Afghanistan before. In the 1980s they both aided Afghans fighting to expel Soviet forces. In terms of human rights, “China was worse then than it is now, yet Sino-US relations were very close,” says Zhu Feng, of Beijing University. Mr Zhu says China should take advantage of the current campaign against terrorism to establish a “new era” in its ties with America. The problem is that unlike Russia, with its continuing influence in Central Asia and intimate knowledge of Afghanistan, China has relatively little to offer.

President Jiang Zemin has adopted an unusually energetic response to the terrorist attacks. He has telephoned several foreign counterparts, including Mr Bush, instead of waiting for others to contact him. He has offered intelligence co-operation. In a further sign of friendship, the two countries this week held

their first talks on human rights since China broke off the dialogue in 1999 in protest at NATO's bombing of the Chinese embassy in Yugoslavia. China has hinted that, in return for its help with terrorism, it would like greater American understanding of its campaign against separatists in Xinjiang and Tibet. But it has not pressed the point.

All this bonhomie, however, will not mean a return to the friendship of the 1980s. In America's eyes, China is more of an uncertain quantity than it was, while once-authoritarian Taiwan has changed into a flourishing democracy. America's long-term worries about China were evident in the four-yearly defence review published at the end of September. That report referred to a “volatile mix of rising and declining regional powers” in Asia, with the possibility that “a military competitor with a formidable resource base will emerge”. China was not mentioned by name, but the message was obvious.

Nor does China's co-operative stance mean that it is completely relaxed about America's actions. Though China fears the impact of radical Islam on Xinjiang's restive Muslims, it does not want to see long-term security involvement by the United States in the region bordering on western China. Already the American campaign against Osama bin Laden has upstaged China's efforts to strengthen its diplomatic hand in the region. The Shanghai Co-operation Organisation—established with great fanfare in June by China, Russia and four Central Asian states, largely in order to combat terrorism—has been strangely silent since September 11th.

China must also worry that the campaign against terror is tying its hands diplomatically. It has had no choice, for instance, but to acquiesce in the Japanese government's plans to provide logistical support to America in Afghanistan. Usually, it reacts with fury to any notion of an expanded role for the Japanese armed forces. To placate China, Mr Koizumi paid a visit this week to a museum near Beijing commemorating Japan's invasion of China in the 1930s (see article). All Mr Jiang could do was to advise him to “remember the wariness of Asian countries”.

For the time being, China appears relatively unconcerned about the alignment of its close friend Pakistan and its “strategic partner” Russia with America. A Chinese military analyst says the eastward expansion of NATO, an idea to which Mr Putin has recently warmed, would not necessarily harm China's interests. “It would become more difficult for NATO to act as a close-knit organisation,” he says. And as long as Pakistan is at loggerheads with India, it will need China's support.

While it concentrates on terrorism, America will be reluctant to pick quarrels with China. But some scholars in China wonder how long that will last. “If the war ends and there is no immediate terrorist threat, hardliners in the Bush administration will again voice their rhetoric about the China challenge,” says Shen Dingli, of Fudan University in Shanghai.

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Japan

Koizumi's rebound

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The war on terror is boosting the fortune of Japan's prime minister

Get article background

WHAT a difference a few planes and ships can make. Only a month ago Junichiro Koizumi, Japan's prime minister, seemed sunk in his troubles. The economy had soured, neighbourly relations with China and South Korea were in a mess and America had grown visibly impatient with Japanese foot-dragging on reform. Yet Mr Koizumi will fly to the Asia-Pacific Economic Co-operation (APEC) forum in Shanghai on October 20th looking politically stronger than he could have dreamed possible a few weeks ago. Japan is going to war and, from Mr Koizumi's perspective, everything is right with the world.

No one, of course, is suggesting that the Japanese should actually fight in Afghanistan: the constitution prohibits it. But new legislation, which Mr Koizumi hopes to hustle through the lower house of parliament before the Shanghai meeting, paves the way, for the first time, for Japan to provide supplies to allies in a war zone far away from Japan. Usually, China and South Korea would be howling at this blatant act of Japanese “remilitarisation”. But mainly because of their need not to offend the Americans, they have stayed silent. Mr Koizumi's mildly more assertive stance has, surprisingly, actually eased tensions.

China and South Korea, for once, are not howling over “remilitarisation”

First up was China, which had been huffing and puffing about Mr Koizumi's visit to a nationalist shrine for Japan's war dead in August. Japanese diplomats had wanted Mr Koizumi to visit China earlier in the autumn to patch things up, but were curtly rebuffed. Mr Koizumi would not be welcome, the Chinese quickly made it clear, unless he apologised for Japan's wartime aggression. Japan's sins, among them authorising a school textbook written by right-wing historians, warranted an especially fulsome apology this time. Nothing short of the “heartfelt apologies” proffered by a former prime minister, Tomiichi Murayama, in a declaration to the Diet (parliament) in 1995 would do.

As everyone knew, this apology would be hard for Mr Koizumi to repeat. Mr Murayama was a socialist. But the fires of nationalism still burn brightly on the racist right wing of Mr Koizumi's conservative Liberal Democratic Party (LDP), which is why he sacrificed foreign neighbours for domestic gain by visiting the shrine in the first place. Yet when Mr Koizumi did eventually arrive in China this week, he not only apologised “from the heart” but fell in with other Chinese demands, like visiting the Marco Polo bridge where, in 1937, Japanese military provocation ignited the Chinese-Japanese war.

Next week Mr Koizumi will be in South Korea, where he plans much the same sort of performance. What has made these apologies possible is Japan's pledged support for America. The Chinese and South Koreans can pretend that Mr Koizumi has come to apologise, rather than to seek understanding for Japan's help in fighting terrorism, which they do not much like but dare not decry. Japan's right wing, on the other hand, can pretend that he is not there to grovel, but rather to trumpet Japan's manly contribution to the war effort in Central Asia.

America is awkwardly grateful for help

The Americans, meanwhile, find themselves awkwardly grateful for the Japanese offer of help. They had been preparing to ratchet up the pressure on Mr Koizumi's much-promised financial reforms, which have been melting away (see article). Paul O'Neill, America's treasury secretary, was due in Tokyo in the week of the attacks on New York and Washington, and the Japanese feared a public dressing-down. In the event, Mr O'Neill cancelled his meetings, Mr Koizumi pledged his support and American criticism duly softened.

At a meeting of G7 finance ministers and central-bank governors on October 6th, Mr O'Neill made no reference to Japan's banking problems, exhorting the Japanese only to boost their economy. That is also something that Mr Koizumi may now find easier to do. Before the attacks in America, Mr Koizumi had pledged to cap the amount of government bonds issued this year, and so start repairing the government's finances, which the LDP has wrecked. With the economy in recession and tax revenues plunging, this cap looked like an increasingly bad idea. Mr Koizumi now has the perfect excuse to abandon it: the LDP's big spenders are already talking excitedly about a special budget to help pay for the war effort.

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North Korea

Pyongyang blues

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Life in the North Korean capital is not sweet for foreign diplomats

IT SEEMED like a good idea at the time. A year ago, Tony Blair joined the rush of well-wishers towards North Korea by announcing that Britain would establish diplomatic relations with the impoverished state. Now the problem is how to set up an embassy in a country that wants to remain hermetically sealed.

The unfortunate man dispatched as Britain's representative is a Korea specialist at the Foreign Office, James Hoare, who took up full-time residence in Pyongyang as chargé d'affaires in July. The British foreign office, caught out by the suddenness of Mr Blair's announcement and the unusual swiftness of subsequent negotiations with North Korea, had no budget for his mission. It had to scrape together money set aside for other diplomatic endeavours.

Mr Hoare and his one subordinate thus find themselves billeted in the dour building that was once the East German embassy, stripped of its better furnishings by other diplomats before their arrival. Now they are struggling with the North Koreans to let them communicate securely with the outside world. Their office has two laptop computers, but there is no local Internet provider and all efforts to connect to one abroad mysteriously fail. Blame North Korea's industrious telephone-tappers, who sometimes audibly play back snatches of conversation while a call is still under way. The North Koreans at first promised to let the British mission set up a satellite communication system, but later backtracked.

This is only the beginning of the British Embassy's travails. In the world's most tightly controlled communist country, even a visit to the circus requires a diplomatic note to the Foreign Ministry. Diplomats are not allowed to have the telephone numbers or even addresses of government departments other than the Foreign Ministry's protocol department. North Korean officials usually meet foreign diplomats on neutral ground.

North Korean officials themselves are so cut off that a western diplomat who telephoned the Foreign Ministry a day after the September 11th terrorist attacks in America to ask the government's response found his interlocutor completely ignorant of what had happened. So much for the winds of change that seemed to be blowing through North Korea last year when its reclusive leader Kim Jong-il suddenly decided he wanted to engage at last with the outside world.

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The UN in East Timor

Any lessons for others?

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The UN's experience in running East Timor should help it elsewhere

THE United Nations had never taken over a country, lock, stock and barrel, until 1999, when it found itself running East Timor. As it begins winding down its presence after a successful election in August that will lead to statehood early next year, it is assessing its record there. There may never be another UN mission quite like the one in East Timor, but it may still hold lessons for future UN action in failed states. Potential candidates are not hard to find. Civil-war-plagued Sierra Leone and Somalia are two obvious examples in Africa. Afghanistan after the Taliban might perhaps be another.

Yet the UN's record in East Timor is patchy. Anti-UN graffiti dot the walls of the capital, Dili, these days alongside the pro-independence graffiti of yesteryear. Some prominent Timorese have been highly critical of the UN, accusing it of favouritism and even of corruption. The UN officials' high wages have created a dual economy, attracting businesses from Australia and Singapore to cash in on the opportunity. If the history of other UN interventions is any guide, they may well pull out after independence next year, taking their pickings with them.

For all that, the UN has achieved a lot in two years, and on a modest budget. It has built up a police force and a defence force. It has carried out an election and built up a judiciary, all virtually from scratch. It has dealt with a wave of militia incursions in 2000, which threatened to plunge East Timor back into chaos. It has repaired some of the worst damage from 1999, although much remains to be done. And after early complaints that they were being excluded, it has brought Timorese leaders into government, giving them the experience they will need to run their country.

Sergio Vieira de Mello, who heads the UN administration in East Timor, says the UN resolution that created it handed him a huge task without really telling him what to do. No-one knew: it had never been done before. The only comparable UN missions were the one in Cambodia in the early 1990s and the current one in Kosovo, neither of which involved taking over an entire country. Despite the criticisms, Mr de Mello says he is satisfied that his administration has created the institutions it was meant to create. The lessons will be noted and tucked away in the UN archives, to be dusted off if they are ever needed, he says. “We could have done this better. We will next time,” he said.

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Dengue fever in Thailand

Don't forget the Autan

Oct 11th 2001 | BANGKOK
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South-East Asia is enduring a particularly bad outbreak of dengue fever

IN COLONIAL times, it was called “bone-break fever”, because of the intense joint pain associated with the disease. Today it is known as dengue fever. But as South-East Asia endures a new epidemic, thousands of people—including tourists—are learning that, whatever the name, the pain is just as intense.

Transmitted by mosquitoes that breed in stagnant water and are active during the daytime, the virus that brings dengue fever, which has no cure and is sometimes fatal, is a perennial problem in the tropics. This year South-East Asia seems to have more mosquitoes than ever, perhaps because of the early onset of the rainy season, higher temperatures and an abundance of containers—flower pots, old tyres, plastic bottles—in which water gets trapped and so mosquitoes can breed. Cases of dengue fever are more than 25% higher than last year in Thailand, and since January over 74,000 people have been infected with the disease, the largest toll in recorded history. In eastern Myanmar, several hundred people are reported to have died from dengue, and Cambodia, Vietnam, and Indonesia have been hard hit as well. The elderly and children—especially tubby ones—are most at risk.

Thailand's health ministry has initiated an anti-dengue campaign that includes spraying for mosquitoes and warnings to women not to wear black stockings, which attract them. Yet some people in Bangkok believe the government has not done enough, especially to warn tourists, and wonder whether the health ministry is playing down the risks for fear of hurting Thailand's lucrative travel industry. In early August, a Thai delegation told officials in Beijing that it was unlikely that foreign visitors would get dengue fever, since the illness was not found in Thailand's big cities—yet the truth is that dengue is actually more prevalent in densely populated urban areas, and several tourists have been stricken already.

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Dissent in Saudi Arabia

The fatwa against the royal family

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AP

The Afghan war carries risks for Saudi Arabia's ruling family

Get article background

LATE last month, a blind 80-year-old sheikh was led before Saudi officials. They had just one question: had he really issued a *fatwa* that in effect excommunicated the al-Saud royal family? “Whoever backs the infidel against Muslims is considered an infidel,” replied the old man.

Sheikh Hamoud bin Oqla al-Shuaibi is no lonely firebrand. He is a prominent scholar who once taught law to the Saudi chief justice. Now, from his home in Burayda in Nejd province, the kingdom's Wahhabi bastion, he has become the standard-bearer of Saudi Arabia's turbulent prelates. When the royal family sought the retraction of his *fatwa*, other religious scholars added their voice, including some mainstream preachers. Anonymous statements pronounced King Fahd and his 30,000-strong family expelled from Islam. All echoed the sheikh's opinion that Muslims had a duty to wage *jihad* on those who attack Muslim states.

These ominous documents risk upsetting the House of Saud's partnership with the Wahhabis, the puritanical sect whose followers consider themselves the only true believers. For 250 years, the Wahhabis have given the al-Sauds religious legitimacy in return for a licence to wage *jihad*, first against neighbouring tribes, then against Shia Muslims, the Ottoman empire and the Soviet Union. They sowed their ideology among Muslims abroad, including the Taliban. But now America, the royal family's backer, is the enemy, and the sheikhs are threatening to transform King Fahd from the patron to the target of *jihad*.

Some dismiss these dissenters as a lunatic fringe. But as a precaution, Prince Sultan, the defence minister, invited a delegation of Burayda scholars to visit him ahead of the American defence secretary's visit last week. Prince Sultan's son Bandar, the ambassador to Washington, defended his father's refusal to join America's military alliance with a rare admission of vulnerability: “In a western democracy, you lose touch with your people, you lose elections. In a monarchy, you lose your head.”

An early sign of violence came on October 6th when a suicide bomber, apparently a Pakistani, struck Eve's, a favourite shop for foreigners in the eastern city of Al Khobar, killing two Americans. Protecting the righteous, he blew himself up during evening prayers. Presumably to avoid inflaming public opinion, the Saudis did not invite Tony Blair, Britain's prime minister, who was touring the region this week.

We're just innocent bystanders in this war, plead the Saudis. But the puritanical clerics have their stern answer from the “Tawhid”, the Wahhabi manifesto, which is compulsory study in schools: one form of

apostasy is “support for the pagan by hand, by tongue or money. As Allah has said, never support the infidels.”

For decades, the al-Sauds have succoured their own opposition. The ultra-orthodox had free rein in schools, the media and the police to enforce bans on music, dancing and showing female faces. School-leavers were given grants to train in Osama bin Laden's camps, public-sector workers were encouraged to spend their holidays on package tours to Afghanistan. Arab *afghanis* (Muslims who fought to expel the Russians from Afghanistan) in London estimate that 5,000-10,000 Saudis have passed through the Afghan camps, and most are now dormant in sleeper-cells. Of the 19 hijackers on September 11th, 12 are believed to be Saudi.

“The al-Sauds have no source of legitimacy besides the Wahhabis,” says a Saudi academic. “They have to find other voices for legitimacy.” This should not be impossible. Only a small minority of Saudi Arabia's 20m or so people are Wahhabis, and most of those who are not, long for release from the Wahhabi stranglehold. But the longer the confrontation is postponed, the greater the risk of a backlash.

From their base in the Nejd, Wahhabis have now spread across the kingdom, establishing strongholds in such isolated corners as Asir, the rugged south-western province from where many of the hijackers are said to have come. Their denunciation of royal corruption, indebtedness to the West and the American hold on the oilfields has a wide appeal.

Youths have been arrested in Abha, Asir's capital, after showing solidarity with the families of the hijackers. And Arab *afghanis* say hundreds of Saudi veterans of *jihad* in Bosnia, Chechnya and Afghanistan have been detained. But Saudi Arabia's rulers are wary of tackling the main source of their own support. After an outburst six years ago, Sheikh al-Oqla was put behind bars. Now officials fear that their customary tactic of silencing him carries too great a risk.

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Al Jazeera

Explosive matchbox

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The Arabic-language television channel that has a front seat in the war

IF THE first casualty of war is truth, the first victor nowadays seems to be satellite television. In the 1991 Gulf war, America's all-news network, CNN, monopolised live coverage from Baghdad. This time Al Jazeera, an Arabic-language current-events channel, has scooped its rivals. By virtue of being the only station with cameras in Taliban territory, Al Jazeera has won millions more viewers, minted cash by selling unique footage, and become a heated battleground in an epic contest for Muslim and Arab opinion.

In the past week, the station has broadcast live images of American air strikes and the destruction they caused, plus an exclusive and fiery statement by Osama bin Laden, who was seen on screen flanked by his top lieutenants, Ayman Zawahiri and Muhammad Atef. To provide the other point of view, it broadcast interviews with the UN's secretary-general and Britain's prime minister. “We are no longer just reporting news,” enthuses Mohamed Jasem al-Ali, the channel's jubilant managing director, “We are making it.”

Al Jazeera's good fortune is not just a matter of luck, although the costly decision made two years ago to open a Kabul office has helped. Since its launch in 1996 the network has established a reputation as the leading independent news source across the Arab world. Compared with the turgid offerings of the state-run channels that dominate Arab air waves, Al Jazeera's mixture of snappy graphics, punchy debates and aggressive reporting and interviewing is eye-catching and controversial.

By presenting raw, rather than predigested content, the channel has undoubtedly contributed to the emotion-charged attitudes that increasingly characterise the Arab public's response to events. This has attracted critics as well as admirers. Arab governments have chafed at being shown in an unfamiliar, often unflattering light. The most recent complaints come from Washington, where officials say there is bias in Al Jazeera's reporting of its campaign against terrorism.

It is true that its reporters are sometimes guilty of over-exuberance. For example, they are inclined to claim that one telegenic student demonstration is representative of a whole country's “street opinion”. Even Al Jazeera's supporters say that its success with audiences has caused a strident and highly politicised tone to creep into some of its programming.

Yet Al Jazeera bridles at suggestions that it should soften its approach. During the Gulf war, notes Mr al-Ali, some westerners dubbed CNN the Voice of Baghdad. Rather than being accused of siding with the Taliban, he says, Al Jazeera should be praised for its determination to present opposing views. Arab media-watchers agree that the channel tries to give equal time to western opinion. Whatever “spin” there may be, they say, is simply due to the cultural attitudes of Al Jazeera's 500 employees, whose diverse national backgrounds make up a reasonable cross-section of middle-class Arab opinion.

Luckily for Al Jazeera, its backers include the ruler of Qatar, the tiny Gulf emirate where the network is based. His government started the channel with a $130m loan, which will soon come due for repayment (given its current run of luck, giving the money back should be a cinch). The network's annual budget is a modest $30m. By contrast, the budget for Egypt's bloated state television tops $1 billion. Which may explain why Egypt's president, touring Al Jazeera's one-storey headquarters, was heard to remark to his minister of information, “All that noise comes from this little matchbox?”

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Iran and Afghanistan

Saying one thing, meaning another

Oct 11th 2001 | TEHRAN
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Don't take Iran's condemnations of the air strikes at their face value

FOR a time, perhaps even for the duration of America's war on Afghanistan, the Iranians have suspended their intense domestic struggle. The opposing factions within the clerical hierarchy, the “reformists” and “conservatives”, have ranged themselves behind the supreme leader, Ayatollah Ali Khamenei, and speak, more or less, with a single voice.

AP

The stage set for an anti-American performance

But that voice is saying, or implying, more than one thing at a time. Iran's leaders reject President George Bush's “for or against us” ultimatum. The air attacks on Afghanistan are condemned as “unacceptable” and their true purpose is doubted. Ayatollah Khamenei leads the chorus in challenging the sincerity of America's war on terrorism. He was televised this week telling clerics that the Americans were motivated by would-be imperialism. The clerics duly chanted “Death to America!” a war cry that, until the air strikes, had been given a rest since the September 11th attacks.

Yet Iran's message is subtler than it sounds. Even after the air strikes began, Kamal Kharrazi, Iran's foreign minister, reiterated his country's willingness to co-operate in a global campaign against extremist groups, through the United Nations. “The campaign against terror can take different forms,” he said. “We simply don't accept military action.”

In fact, Iran's wishes for a future Afghanistan—planners are already discussing the make-up of a post-Taliban regime—are not unlike America's own. Both countries support the idea of a transitional government, led by ex-King Muhammad Zahir Shah, in partnership with the opposition Northern Alliance. Iran's important caveat is that such a government should be set up under the UN's auspices.

As one of the few countries with a functioning intelligence network inside Afghanistan, Iran could have a certain influence over what happens next. Indeed, if Pakistan's security situation deteriorates, Iran could emerge as an influential actor in the region.

In any event, and regardless of what it is now saying, Iran is not at all ill-pleased at the prospect of the collapse of the Taliban regime. “A change of government in Afghanistan could solve Iran's border problem, its refugee problem and its drug problem,” says a European diplomat in Tehran. “And Iran wouldn't even have to lift a finger.”

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Zimbabwe

While you looked the other way

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Robert Mugabe's broken promises

AP

After their farm was burnt

A LEADING official of President Robert Mugabe's ZANU-PF party was vehement. “We will stop at nothing to make sure that Mr Mugabe wins another term,” he snarled to a startled European diplomat. “If it takes violence, then we will use violence. If you thought the parliamentary elections [in June 2000] were violent, they will seem like nothing compared with the presidential elections.” Though taken aback by the party leader's brutishness, the diplomat was not surprised by the message. In recent weeks it has become clear that Mr Mugabe, aged 77 and in power for 21 years, is preparing to use every trick in the book to get re-elected next year to another six-year term.

He has been an unintended beneficiary of the September 11th attacks on America. As international attention dwells on that crisis, the scrutiny of Mr Mugabe has diminished. The postponement of the Commonwealth heads-of-government meeting from October to March means that, by the time the rescheduled talks are held, his re-election plans will already be fully in place (the election has to be held by the end of March).

Mr Mugabe has taken advantage of this inattention. Forget the assurances he made to a group of Commonwealth foreign ministers, in an agreement reached in Nigeria on September 6th, that he would stop political violence and illegal land invasions. Forget, too, his promise, a few days later, to the leaders of the Southern African Development Community (SADC) that he would curb his thugs from intimidating the political opposition.

Since then, his supporters have carried out 30 new farm invasions, and violence has stopped work on some 700 farms during the planting season. The deaths of three people have been blamed on state-sponsored political violence. The by-election in Chikomba on September 22nd and 23rd was particularly violent. A school headmaster, accused of supporting the opposition MDC, was beaten to death. Other teachers in the region were tortured on the general suspicion that teachers are bound to be on the opposition's side.

It now seems clear that Mr Mugabe's new-look Supreme Court will draw a veil of legality over all this. The new chief justice, Godfrey Chidyausiku, chose three newly appointed justices, all known to be government adherents, for a crucial land case. Reversing an earlier Supreme Court judgment, they ruled last week that the land seizures were legal, and directed the government to proceed with them.

Much is at stake in the courts. The Supreme Court is due to hear cases on political violence, electoral fraud, intimidation of the press and the government's intention to strip citizenship from scores of thousands of Zimbabweans, including those of British descent. But, laments a leading lawyer, “There is no longer an independent judiciary, there are just a few independent judges.”

Yet, even with all this help, Mr Mugabe may have trouble getting himself re-elected, let alone credibly. In the Chikomba by-election, in a campaign rife with violence and intimidation in the Mashonaland heartland of ZANU-PF territory, the MDC still managed to win a quarter of the votes. A strong minority of the votes in rural areas will boost the manifest support the MDC has in the capital, Harare, and in other cities, as well as in the entire Matabeleland region. Economically, the country is a disaster, with inflation heading towards 100%. Price controls were imposed this week. Optimists note that last year the president unexpectedly lost a referendum on his proposed constitution.

Moreover, not all eyes are off Zimbabwe. Mr Mugabe's blatant flouting of the Commonwealth's and SADC's accords has affronted those organisations. SADC's leaders have ordered a ministerial team to investigate what is happening in the country, and the Commonwealth may follow suit. After the government ejected an American team preparing to monitor the approach to the election, and told a European Union delegation not to come, both America and the EU are considering selective sanctions. But attention, and pressure, need to be arduously maintained.

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Congo

Putting Humpty together again

Oct 11th 2001
From The Economist print edition

Congo's government and rebels prepare for peace talks

Get article background

BELATEDLY, Congo's “national dialogue” is to start on October 15th in Ethiopia's capital, Addis Ababa. A peace agreement, signed in Lusaka in 1999, says that these talks should produce a new political system, a new government, an integrated army and national reconciliation. But at mid-week the questions of who would be there and what would be discussed remained unanswered.

In 1999, the neighbouring armies that had intervened in the conflict were still locked in battle: Uganda, Rwanda and Burundi on the rebels' side; Angola, Zimbabwe and Namibia backing Congo's president, Laurent Kabila. The agreement gave all the Congolese forces equal standing. Since then, the balance has shifted. The Rwandans and Ugandans, who were in the ascendancy, have lost respectability—not least by fighting each other—and the young Joseph Kabila, who succeeded his assassinated father as president last January, has gained a certain stature.

The next step starts on Monday, when some 380 delegates from Congo's government, the three rebel movements, the political parties and the church and other non-governmental groups are supposed to sit down around a horseshoe-shaped table under the chairmanship of Ketumile Masire, a former president of Botswana. There is money to keep the conference going for four to six weeks.

But it is by no means in everybody's interest to agree to make Congo a single state again. The neighbours, including some of their top politicians and soldiers, are making good money out of the war and have little incentive to leave. It suits them to have a ceasefire so that everyone keeps what he now holds. Mr Kabila and his allies have the capital and the mineral-rich south-east, and an agreement would mean him stepping down as president.

On the other hand, Jean-Pierre Bemba, whose Movement for the Liberation of Congo most directly threatens the capital, would like to live there and have a job in government. But he too is keeping his powder dry and his fighters in training. The other rebel group, the Congolese Rally for Democracy, has split in two. The part controlled by Rwanda could gain from an agreement, but the other, a puppet of Ugandan military-commercial interests, prefers the lucrative status quo.

Given all this, not too much should be expected from Addis Ababa.

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France and the fight against terrorism

Aux armes, citoyens?

Oct 11th 2001 | PARIS
From The Economist print edition

France is behind the United States—but with some qualms

ALMOST as soon as the first of America's missiles struck Afghanistan, President Jacques Chirac, his demeanour sombre and his voice solemn, addressed the French nation: “Our forces will take part. We will assume our role in a spirit of solidarity and responsibility.”

Indeed. As action began, a French refuelling ship and a missile-launching frigate were patrolling with American and British fleets off the coast of Oman; undercover French agents were already on the ground in Afghanistan; and Alain Richard, the Atlantic-leaning minister of defence, was talking of the possible involvement of France's special forces, many of them already dispatched to France's military base in Djibouti, in the Horn of Africa.

But note the president's grammar. While Britain's Tony Blair could speak in the present tense on October 7th, Mr Chirac could use only the future. The fact is that some transatlantic relationships are closer than others; and the fear, witness an interview given to an American paper by Pierre Lellouche, a conservative MP, is that “France is going to end up being completely out of the loop in the major developments already under way.”

Perhaps Mr Lellouche is right. After all, the Americans have painful memories of French bolshieness in defence matters. First there was the era of General de Gaulle, who pulled France out of NATO's military structure (which partly isolated its forces, to their chagrin, during the Gulf war of 1991). Later, France reluctantly toed an American-drawn line in the Balkans, and now it is hurrying to create a European rapid-reaction force which some in America and Britain think is meant not to complement NATO but to compete with it. Put all that together with political differences—notably France's disagreement over sanctions against Iraq and the British-American air campaign against it—and it would hardly be surprising if America kept faithful Britain in the loop and fickle France outside it.

But so what? It is arguable that France is better off at arm's length from America rather than in its embrace. One reason is that otherwise it might become impossible for the French presidency, held by the conservative Mr Chirac, and the left-wing government, led by the Socialist Lionel Jospin, to keep to the tradition that in security and foreign affairs France should “speak with one voice”. This institutional cohabitation often produces a compromise based on the lowest common denominator; besides, Gaullism has become the foreign policy of both right and left in France, a response above all to the cultural and political predominance of American power. In any event, Mr Chirac did his best to ensure that Mr Lellouche was kept away from the spotlight during a special parliamentary debate on the terrorist

attacks—even though he is a member of the president's own Rally for the Republic (RPR) and once advised Mr Chirac on foreign affairs.

A second reason is that to follow America too closely would risk the break-up of Mr Jospin's coalition, which the prime minister would rather avoid in the approach to the presidential election next spring, when he is expected to challenge Mr Chirac. Mr Jospin, with a pro-Americanism that belies his early years as a Trotskyite, declared in last week's debate: “The struggle against terrorism calls for solidarity and co-operation. Our solidarity is first with America, the ally to which we owe victory over Nazism, the friend with whom we jointly affirm the ideal of democracy.” Yet in the same debate Robert Hue, whose Communist Party is a part of Mr Jospin's coalition, underlined the risk that military action might hurt the innocent and announced: “We, for our part, will oppose it and, therefore, will oppose any French participation.”

So, too, the Green Party, another part of the coalition. No sooner had the attacks started than Noel Mamère, who may soon emerge as the Green's candidate for the presidency (the present candidate has made too many gaffes), denounced them as “an act of war against the Afghan people”, arguing that terrorism should not be fought with air strikes but with international law in “a fight against poverty and murky financial transactions”.

But there is a third reason, perhaps more important than the self-interested jockeying of France's politicians. This is the presence in a French population of 60m of 4m-5m Muslims, most of them of Arab and especially North African origin. A poll carried out for *Le Monde*, *Le Point* and Europe 1 radio station after the terrorist attacks on America (but before the first attacks on Afghanistan) makes interesting reading. France's Muslims, who declare themselves more religious than in previous polls, are almost all against terrorism (92% say it is contrary to the Koran) and are ready, by some 70%, for France to help America in its search for terrorist networks. But 68% say they can understand how American policy in the Middle East may have pushed Islamic extremists to the limit, and 69% would oppose French participation in a war against states that harbour or help terrorists.

Such opinions will be ignored only at the risk of social peace, particularly in the *banlieue*, the working-class suburbs with large ethnic minorities that surround most French cities. On October 6th, the eve of the attacks on Afghanistan, the French and Algerian soccer teams met in Paris for the first time in their history—and young French-born Muslims whistled during the French national anthem; forced the abandonment of the match with a good-natured, Algerian-flag-waving invasion of the pitch; and threw bottles at two government ministers, both of them women.

Meanwhile the French police have rounded up around 30 Muslims suspected of terrorism or having terrorist connections, including four thought to have been planning an incident for the soccer match, and there are suspicions that last month's deadly explosion at a chemical plant in Toulouse may, after all, not have been accidental. Against that background, Mr Chirac and Mr Jospin may conclude that solidarity with America is a wonderful concept—but one that is best exercised with words and intelligence (of both kinds) rather than too many deeds.

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Sweden's neutrality

The past is past

Oct 11th 2001 | STOCKHOLM
From The Economist print edition

In lining up against terrorism, Sweden is accelerating a change already begun

AP

No more fence-sitting for Lindh

WOULD the Swedes rally to George Bush's war on terrorists? It may not have looked likely. For a start, they have long called themselves a neutral country. Second, for most of the past half-century, their left-leaning governments have readily criticised America's “imperialism” and its use of force, from Vietnam to Iraq. Yet Goran Persson and his cabinet have not only fiercely denounced the atrocities of September 11th—“an attack on us all”—but they have pledged almost unreserved support for any retaliation.

How come? Not least, because Sweden has long been quietly softening its dogma of neutrality. The end of the cold war and its membership, since 1995, of the European Union have brought Sweden into European security affairs. Its forces have taken part in NATO exercises and have served as peacekeepers in the Balkans. The ruling Social Democrats regard neutrality as an anachronism these days, and have held a series of talks with Sweden's other parties aimed at reaching a consensus on a new defence policy stressing non-alignment but making no mention of neutrality.

It has not happened yet. The Greens and the ex-communist left, whose votes the government needs in parliament, want to stick with neutrality; in the opposition, the Liberals and the conservative Moderates want Sweden to enter NATO. But now the terrorist attacks in America have lent the trend a new dynamic. The Social Democrats' party executive has been quick to argue that the threat posed by terrorists and the risk that they will get hold of weapons of mass destruction “radically change” Sweden's security needs.

Anna Lindh, the foreign minister, has even suggested that Sweden would be “unlikely” to stay neutral if an armed conflict should break out nearby. Nobody speaking for Sweden has gone so far for decades. The Swedes will not be rushing to knock on NATO's door, or even to join the planned EU force. But their days as dyed-in-the-wool neutrals are over.

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Turkey and the war

Western outpost

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AP

American bombers, Turkish barrows

Turkey strongly backs America—but is reluctant to make Iraq a target too

AP

American bombers, Turkish barrows

ONCE again, Turkey is happy to prove itself a true friend of the West in time of need. It has been unwavering in support of the United States since September 11th. In the past few days, American bombers heading for Afghanistan have flown through Turkish air space, and American transport aircraft have refuelled and picked up supplies at Incirlik, the NATO air base in south-eastern Turkey. Western governments have heaped praise on NATO's only Muslim member. “A shining crown jewel,” declared Curt Weldon, a visiting Republican congressman.

The country's three-party coalition of left and right rushed a bill through parliament this week to let the government dispatch Turkish troops abroad. This has stoked up rumours that Turkish special forces may take part in an eventual ground operation in Afghanistan. It seems plain that Turkey wants to be in on any military action that America's allies take.

As usual, it is making the most of itself as a geopolitical pivot on which the Balkans, the Middle East and the oil-rich Turkic-speaking republics of ex-Soviet Central Asia, such as Uzbekistan, converge. For the past decade, British and American aircraft based at Incirlik, only 100km (62 miles) from Syria's border and 500km from Iraq's, have patrolled a “no-fly zone” over Kurdish-controlled northern Iraq, often hitting Iraqi military targets outside the haven for the Kurds declared by the allies at the end of the Gulf war.

Since September 11th, retired Turkish generals have been saying on television that Turkey is now sure to get into the European Union. Many outsiders have previously reckoned that Turkey's economy is too shaky, and its attitude towards human rights too contemptuous, for it to be let into the club. For months, to immense irritation all round, Turkey has been blocking arrangements that would allow the EU's nascent rapid-reaction force to be assured of using NATO equipment and planning procedures. Can a deal now be brokered, or will Turkey overplay its hand? Optimists think Turkey's chances of joining the European mainstream have improved. Meanwhile, they parade Turkey's market democracy as a model for the rest of the Muslim world.

Many Turks think, too, that western countries will become more sympathetic towards Turkey in its own battle against terrorists (as they call the Kurdish insurgents in the country's south-east). And most western diplomats in Ankara, Turkey's capital, reckon the extra money from the IMF that the Turks have been seeking to prop up their economy will now flow in. “Keeping Turkey on its feet is in our own interest,” said one of them this week.

But some Turks are worried. They fear that, once the alliance has dealt with Afghanistan, it may turn its guns on Iraq. “That would have disastrous effects on Turkey and on the region as a whole,” says a Turkish diplomat who handles the Middle East. Turkey has long argued that the overthrow of Saddam Hussein's regime might break up Iraq and lead to the creation of an independent Kurdish state on Turkey's border. That would in turn fuel separatist feelings among Turkey's own 12m or so Kurds, just when a 15-year rebellion by the Kurdistan Workers' Party has been showing signs of fizzling out. Turkey's army chief, General Huseyin Kivrikoglu, said recently that “we will never accept the establishment of an independent Kurdish state [in northern Iraq].”

Until September 11th, Turkey, against the strong advice of Mr Bush's administration, had been quietly renewing ties with Iraq. Earlier this year it posted a full-time ambassador to Baghdad. Turkish business delegations have been visiting the Iraqi capital. Before the Gulf war, Iraq was Turkey's second-largest trading partner; Turkey says it has forfeited over $40 billion in trade because of the UN's continuing sanctions against Iraq. For some time, Turkish voices saying that it is time for Turkey to look after its own interests in this matter have been getting louder.

With that in mind, Turkey has been negotiating with the Iraqi regime to open a border crossing that would give it direct access to areas under the regime's control. It can already use the Habur crossing that opens the way to the part of northern Iraq run by Iraqi Kurds. Some 500-1,000 Turkish troops are permanently deployed in the rugged mountains bordering northern Iraq to hunt Kurdish guerrillas lurking on the Iraqi side.

But since September 11th Turkish policy has shown signs of shifting. Things would change even more dramatically if renewed American action against Iraq finally precipitated the downfall of the regime. To stop the Kurds from taking over Iraq's oil-rich provinces of Kirkuk and Mosul, the Turks might well feel obliged to send their own troops there instead. That would provoke vigorous resistance by assorted Kurds and might suck Turkey into yet another war—which is why Turkey would rather the United States resisted the tempation to have another go at Mr Hussein.

Moreover, recent opinion polls suggest that many Turks are against involvement in military action against Afghanistan or against any of Turkey's Muslim neighbours, Iraq included. Though radical Islamist groups in Turkey are still small, they could soon gain more recruits, as unemployment and inflation go up. The generals' relentless campaign against Turkish Islamists of all stripes is sure to help them. One Islamist, Mustafa Karaalioglu, derides the much-vaunted notion of Turkey as a bridge between Islam and the West “when it has yet to make peace with its own pious citizens.” And more overt Turkish military action alongside the Americans would also anger the many Arabs already annoyed by Turkey's military ties with Israel.

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Georgia and Russia

Strange bangs

Oct 11th 2001 | MOSCOW
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Trouble is brewing in the Caucasus as Chechen fighters head west

WHOEVER is behind it, a nasty conflict is brewing again in a remote corner of Georgia. Some 200 armed men—or perhaps more than 1,000 of them, depending on whom you believe—are holed up in one of the most inflamed bits of that dirt-poor, badly-run country. Some or most of them are Chechens, apparently bent on opening a second front. Someone, presumably they, shot down a UN helicopter this week, killing all nine people on board. The next day aircraft and helicopters, probably Russian, bombed them.

At least 14 locals have been killed in the latest fighting. The kerfuffle highlights a fragile peace between Georgia and its breakaway region of Abkhazia, an internationally unrecognised statelet propped up by Russia since a brief and bloody civil war in 1991. The fighters are in the Kodori gorge, the only bit of Abkhazia partly under Georgia's control. The Abkhaz say the Chechens have teamed up with Georgian paramilitaries who have been keeping up a sporadic guerrilla war in the region and are now planning to attack the capital, Sukhumi.

Russia says the incident is just the latest proof that Georgia is soft on terrorism and unwilling or unable to control its border with Chechnya, whose rebels, it says, seek solace on Georgian soil. Russian officials add privately that Georgia, as well as being an unreliable neighbour, is riddled with crime and corruption. For its part, Georgia says that Russia is bullying it, using the anti-terrorist cause as a pretext for restoring influence in its former Soviet empire. Some Georgians, recalling that Chechens fought on the Abkhaz side in the 1991 war, think the whole thing a devious Russian stunt to make the Georgians look bad.

The truth is hard to fathom. Russia's record in the area is poor. It broke a promise to shut its military base in Abkhazia by July, pleading protests by the locals, who see Russia as their protector. But Georgia is open to criticism too. Its government has abjectly failed to tackle corruption; its western-educated justice minister, Mikheil Saakashvili, recently resigned in disgust over the issue. Georgia's poorly-paid, badly-led border troops would be little obstacle to a bunch of determined Chechens.

What next? The fighters may melt away as mysteriously as they appeared. They may be defeated by the Abkhaz forces, which claim to have them surrounded. They may indeed break out and attack Sukhumi. They may even head north to another part of Russia's southern fringe, though they would be unwise to clash head-on with Russian forces. They might, in the worst case, give the Kremlin an excuse to intervene more aggressively in Georgia, as the rest of the world looks elsewhere.

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Charlemagne

Michael Steiner

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The German chancellor's foreign-policy adviser is prodding his country into taking a bigger role abroad

IN THE Gulf war of 1991, Germany sat nervously on the sidelines, contributing only cash to the allied effort. Ten years later, in the aftermath of the terrorist attacks on the United States, Chancellor Gerhard Schröder was among the first to declare his “unlimited solidarity” with the Americans. Germany, he said, was ready to “take risks, even military ones” in the fight against terrorism. He ruled nothing out. So wholehearted a promise, made again to George Bush in Washington this week, marks a milestone on the long road travelled by Germany since it regained full sovereignty in its foreign affairs after its unification in 1990. It may even prove a turning-point for Germany's role in the world. Once derided as “an economic giant but a political dwarf”, the country is plainly fast becoming a bigger actor on the global stage—to the particular delight of Mr Schröder's main foreign-policy adviser, Michael Steiner.

In the early 1990s, still bound by the inhibitions of its past, Germany was reluctant even to send troops on humanitarian missions to places such as Cambodia and Somalia. Not until 1995 did German soldiers first join a NATO peacekeeping mission, in Bosnia. Four years later they went into armed combat for the first time since the second world war, in Kosovo. Last year, also for the first time, a German general took command of NATO peacekeepers, again in Kosovo. And last month yet another precedent was set when Germany was put in charge of NATO's very tricky peacekeeping mission in Macedonia. Now Mr Schröder is promising to give the Americans as much help as he can in their war against terror—and has managed to get most Germans, including even the traditionally pacifist Greens, behind him. It has been a remarkable progression.

When he was first elected chancellor, Mr Schröder blithely admitted he knew “nothing” about foreign affairs. His horizons had largely been confined to his home state of Lower Saxony, where he had been premier. He had never had a job in the federal government. But since coming to power, he has learned fast about diplomacy. Especially in the past year, he has got a taste for it. Many in Berlin give special credit for this to Mr Steiner.

A former diplomat, he was plucked by Mr Schröder in 1998 from the relative obscurity of being ambassador in Prague to become the closest thing, in American terms, to national security adviser. The two men, both once lawyers, had never met. Mr Steiner had a reputation as an almost fanatical workaholic who was hard to work with but got things done. He made his mark in the Balkans in the 1990s as a member of the western “contact group” (then chaired by a Briton, David Owen) and later as deputy to the “high representative” in Bosnia, Carl Bildt, a Swede. Indeed, Mr Steiner was tipped to succeed Mr Bildt in the job, but the German chancellor of the day, Helmut Kohl, vetoed his appointment, probably because of Mr Steiner's turbulent past. He had been a student rebel in Munich in 1968 and had long supported Amnesty International. In 1989 he won a lot of publicity as a junior diplomat in Germany's embassy in Prague, when he had been shown on television, hauling refugees over the embassy wall and out of the clutches of the Czech police.

Though not in Mr Schröder's intimate inner circle, Mr Steiner is a close adviser. He sees the chancellor at least once a day, often several times. He goes on all his foreign trips. And it is to him, rather than to Joschka Fischer, Germany's Green foreign minister, that Mr Schröder usually turns for instant counsel on foreign matters. Not surprisingly, this creates bad blood between the foreign ministry and the chancellery (as happened in the 1990s when Horst Teltschik and Joachim Bitterlich had Mr Kohl's ear). But after a shaky start, the energetic, blunt Mr Steiner and the clever, vain Mr Fischer seem to be getting along.

No longer shackled by a guilty past?

Long before September 11th, Germany was struggling to find a new place in the world. When Mr Schröder first took office, he rattled many foreigners with his bald assertion that Germany had “come of age” and would pursue its own interests without its old guilt complex. Many feared that they would soon see a pushier, even arrogant, Germany strutting on the world stage. Some were even afraid that it might start bossing smaller countries around in its sphere of interest. This has not happened. For sure, Germany has become more confident, but it has shown no tendency to throw its weight around or to act alone. It clearly wants to wield more influence abroad; indeed, it feels it has a duty to do so, both because of its economic might and its strategic position at the heart of a European Union that is expanding to the east. But it is still wedded to the notion that it must yoke its foreign policy to other countries in the EU and in NATO. And it still likes to work under the umbrella of the UN.

If, as may well happen, a new web of allegiances takes shape in the aftermath of September 11th, Germany may have a further chance of finding a new role. Mr Steiner certainly thinks so. “The high degree of international responsibility we are expected to shoulder is something new,” says his boss, Mr Schröder, with some relish. “After long periods of confusion in the 19th and 20th centuries, Germany has at last joined the West. That's what's at stake for us. The argument that we cannot take part [in military missions abroad] because of our history no longer holds true.” Mr Schröder seems so keen to display his steadfastness at the Americans' side that he is prepared even to risk breaking his red-Green coalition. As an aide puts it: “Only when we sit in the boat and help row can we hope to have a say in the tempo and direction of the journey.”

Mr Steiner believes that the events of September 11th may change the architecture of world affairs. A decade after the cold war's end, Germany is still striving to become normal. Now, maybe, it will be easier for it to take its rightful place among the countries that are powerful enough to help build a new order.

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Railtrack's bankruptcy

Blood on the tracks

Oct 11th 2001
From The Economist print edition

The government had no real alternative but to declare Railtrack bankrupt. It was like putting down a very sick dog

Reuters

Get article background

ON THE evening of October 5th, the transport secretary, Stephen Byers, called in John Robinson, the boss of Railtrack, owner and operator of Britain's railway network, to tell him that he was going to announce that the company was bankrupt. Mr Robinson was astonished. Sir Alastair Morton, the government's rail supremo, was, according to insiders, “gobsmacked”. Tom Winsor, the rail regulator, was equally amazed when he received the news in a phone call from Railtrack the following day. Only a week earlier, he had said: “What the railway industry needs most is stability, predictability, clarity of responsibility, sound incentives and an overall environment which is friendly to investment.”

The contempt with which Mr Byers treated the men the government had appointed to run Britain's railways was born of frustration. They were supposed to sort out the mess and they had failed. But they never had much of a chance. The bankruptcy is the direct consequence of the way the railways were privatised by the Conservative government in 1996.

The problem always centred on Railtrack, which was charged with operating a run-down network. From the day of privatisation its revenues were more or less fixed, according to a formula laid down by its regulator. But nobody, not least Railtrack's management, knew what its costs would be. There was no proper inventory of the state of the track and signals, and therefore no idea of how much investment would be needed to fix them. Even super-managers could not have made a go of Railtrack, but the company was anyway not blessed with talent. Its current managers have been struggling with the mess their predecessors left.

It took three crashes, most importantly the Hatfield disaster last October caused by a cracked rail which should have been repaired months earlier, to underline the fact that the network was not just crumbling, but also unsafe.

The Hatfield crash marked the beginning of the end for Railtrack. Worries that the whole network might be full of cracked rails led to drastic speed restrictions and expensive repairs. The financial cost of all this was revealed last May when Railtrack produced its annual results—a pre-tax loss of £534m, compared with a profit of £360m the previous year. Even more alarmingly, it revealed a financial gap of nearly £5 billion ($7.25 billion) over the period to 2006, partly caused by Hatfield. This was after the government had agreed a month earlier to advance £2 billion of grants to the company. Railtrack also revealed that it faced huge potential liabilities, such as those caused by delays in upgrading the West Coast main line.

From then on, Railtrack's biggest problem was no longer fixing the rail network, it was fighting to survive. By this stage its share price had collapsed, which ruled out recourse to the equity markets. Its balance sheet, with £3.3 billion of debt, could not cope with much more. The worry for lenders was increasingly that profits would not be robust enough to ensure that interest payments would be met. By now, it was obvious that the company had only one place to go for most of the money it needed: the government. So the company was going to have to ask taxpayers to bail out its shareholders. Given that Railtrack had been privatised, shareholders were supposed to bear the risk.

For shareholders who had instead assumed that the government would always come to Railtrack's rescue for political reasons, there was more bad news. The government said in April that it would continue to support the railway industry as a whole, but not necessarily individual companies. Railtrack made the government's policy clear to the stockmarket with a formal notice. A new chairman, Mr Robinson, and a new finance director, David Harding, were appointed to back up the chief executive, Steve Marshall, who was put in place after the Hatfield disaster. Flanked by their advisers from CSFB, an investment bank, they approached Mr Byers on July 25th to talk about three possible ways out: a government bail-out, re-nationalisation and receivership.

Mr Byers was new to the job as well, having been made transport secretary after the general election in June. Labour had ruled out straight re-nationalisation in its election manifesto.

Alarmed by Railtrack's presentation of the financial situation, Mr Byers called in his own advisers, Schroder Salomon Smith Barney, in mid-August. Railtrack presented him with two sets of bail-out proposals, codenamed Project Rainbow, in August and September. While these plans were complicated, both of them were, in essence, asking Mr Byers to write a blank cheque for the company. The only potential upside for the government was that it might acquire an equity stake in Railtrack.

Unbeknownst to Railtrack, Mr Byers was beginning to think that receivership had certain political attractions. The company was hugely unpopular, and yet another bail-out funded by taxpayers would be met with outrage because, in effect, the government would obviously be assuming a risk that was supposed to be borne by the shareholders.

Meanwhile, Railtrack was due to announce its half-year results in November. As part of this announcement, the company would have to tell the stockmarket that it had adequate finances in place to continue trading. To do this, the firm needed Mr Byers's support for the bail-out. Things came to a head at a crucial meeting on October 3rd when Railtrack's bosses spelled out how urgently a rescue package was needed if the company was to be saved.

But Mr Byers had a radical alternative: to petition the court to put the company into insolvency, using special powers under the Railways Act. A new private company would be set up to own and run the network. It would have no shareholders, and would be financed through the bond market.

On October 5th, Mr Byers was told by the Office of National Statistics, the arbiter of such matters, that the new company's borrowings would not count as part of the government's borrowings. This was essential to win the support of the Treasury. That made up his mind. His decision had the added advantage that it would entail a clear-out of Railtrack's management, and the opportunity to devise a more sensible regulatory structure.

In putting Railtrack into insolvency, Mr Byers was only doing what the company would anyway itself have had to do within weeks. But when the details of what he has in mind for the re-born Railtrack are worked out, he still runs a political risk: the new structure will nevertheless require large sums of taxpayers' money, and he has to prove that whatever takes charge of the railways will work better than the old Railtrack did.

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Inward investment

Where have all the foreigners gone?

Oct 11th 2001 | EDINBURGH
From The Economist print edition

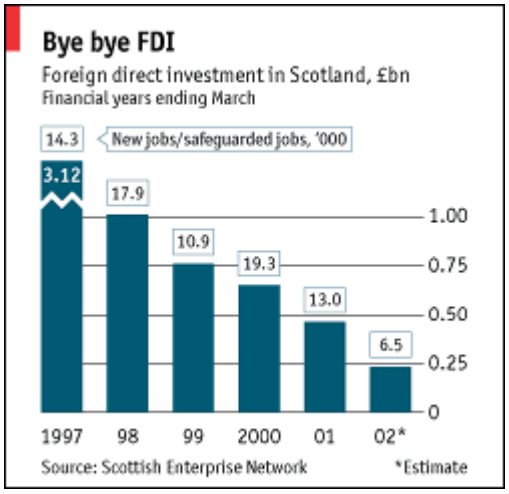
Inward investment is dwindling painfully in Scotland, Wales and northern England

IN RECENT years, Britain has done well at attracting foreign investment. Last year Invest.UK, the government's inward investment agency, recorded 869 incoming projects expected to create 71,000 jobs. But now the flow of investment seems to be drying up.

In Scotland, Wales and the north of England, foreign direct investment (FDI) has replaced jobs lost in declining industries such as coal-mining and ship-building. In Scotland, 140,000 people, about 6% of the workforce, are employed by foreign-owned firms. While some of these jobs have come about through mergers and acquisitions of Scottish firms, most have been created by new investment.

According to Scottish Enterprise, the country's main economic development agency, FDI has created about 15,000 new jobs a year over the past five years. But Robert Crawford, the agency's chief executive, says, “These days are over.”

The value of FDI in Scotland has been falling for some years (see chart). But the number of jobs being created held up, because labour-intensive service companies have been replacing costlier manufacturing plants. Now both the value of the investment and the number of jobs are falling. Mr Crawford reckons that the flow of FDI has halved this year, and that things have got worse since September 11th. American investment makes up about 50% of European FDI. “I have never known anything quite like this in my time in this business,” he says.



The Scottish experience is by no means unique. A recent report by the United Nations Conference on Trade and Development (UNCTAD) forecast a 40% drop in worldwide FDI flows this year. This is mainly because the last two years' figures were bumped up by a wave of big mergers and acquisitions that has now subsided. But new investment is also declining.

The global economic downturn is partly responsible for the downturn in FDI. But changes in the way companies operate are also responsible. Big companies are less inclined to build their own factories these days, preferring to sub-contract the work to other firms. And there is always the temptation, both for sub-contractors and for the firms themselves, to put factories in places where workers are fairly cheap and fairly skilled, such as India, China or Eastern Europe.

Scotland (and to a lesser extent Wales and the north of England) is particularly vulnerable to the downturn. All three areas devoted much effort, successfully, to luring firms in information technology and communications, which is now in recession across the world. Firms are shelving expansion plans and cutting back on existing production. Motorola abandoned a plan to spend £1.3 billion ($1.9 billion) this year on a new semiconductor factory in Scotland and closed a mobile-phone factory, sacking 3,000 people.

The picture is not entirely gloomy. Motor manufacturing continues to be a stable part of the north-east's economy. Ford is spending £246m this year on expanding its engine plant in Wales. Financial services are still growing in Scotland, and new call-centres are being set up in northern England and Wales: a big bank is due shortly to announce the construction of a 600-job call-centre in Cardiff.

Nevertheless, the outlook in the regions does not look good. Business Strategies, an economic forecasting firm, expects unemployment to rise next year in the Midlands, the north and Scotland, and although it thinks that overall Welsh employment may rise a little, it forecasts no economic growth in Wales.

These trends are forcing economic development agencies to rethink their strategies. Luring in high-volume, low-value assembly work is out. Instead, they are concentrating on persuading firms to set up research, design and development laboratories. The aim is to convince big companies that they can make use of expertise in universities and other research facilities through collaborative ventures.

Scottish Enterprise is so convinced that this is the only way to go that it has re-named Locate in Scotland, its inward investment arm, as Scottish Development International. It is, for example, talking to MMI, a biotechnology company based in Cambridge, about setting up a biotechnology and nanotechnology research facility at Livingston that would make use of Scottish graduates and university medical research, and might eventually employ 500 people. The Welsh Development Agency is fostering an electronics research facility next to the University of Wales, Swansea, and Sheffield City Council is setting up another such centre with Sheffield's two universities.

If this strategy works, it will create well-paid jobs for well-educated people. But it will not offer employment to the thousands who found work in the factories that the foreigners used to build.

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Business and crime

Putting up the shutters

Oct 11th 2001 | BRADFORD
From The Economist print edition

For many businessmen in Bradford, the summer riots might as well still be going on

Reuters

Local entertainment

SHUTTING up shop in Bradford city centre takes a little longer than elsewhere. Take “The Lemon Shed”, for instance, a men's clothes boutique. Every night when the owner locks up, he pulls down the reinforced steel shutters and then bolts his new “Bulldog Anti-Ram” barrier into the pavement. He installed that after a ram-raiding gang drove a car into the shop door, buckling the steel shutters but fortunately failing to get into the shop itself. A nearby clothes retailer was less lucky. He was cleaned out last week by what the shopkeepers presume is the same gang. At the moment, the gang prefers to work on Monday nights, between 9pm and 10pm.

According to Bradford's businessmen, this sort of thing is quite common. The crime wave, they say, is jeopardising the city's chances of recovering from the riots in June, when police fought street battles with Asian and white gangs.

The burnt-out pubs and garages on White Abbey Road, at the centre of the violence, are a standing reminder of the effects on business of the summer riots. But John Pennington, president of the local Chamber of Commerce, says that businesses were being attacked before the riots, and that the violence has escalated since. Takings at his own business, the largest nightclub in Bradford, have halved since June. His club has also been firebombed, and the charred remains of his two club buses, worth £20,000 ($29,000), are rotting in his car park. They were set alight just three weeks ago.

It is hard to gauge the extent of the crime. The local police have only just started collecting statistics on crime against business, and the Chamber of Commerce has yet to collate the information it is collecting from its members. But plenty of businessmen are eager to tell their stories. As well as the attacks on the eponymous Penningtons, Omar Khan has had his city-centre restaurant fire-bombed, causing £2,000-worth of damage. A cinema, AsianCine, owned by Nirmal Singh, was burnt out, causing £260,000-worth of damage. None of the perpetrators has been caught.

Businessmen believe that they have been targeted for a number of different reasons. Plain old-fashioned hooliganism is widely blamed. But Mr Singh suspects that his cinema might have proved too racy for some Muslims. And Mr Khan thinks that he was picked on for trying to make peace between rioters and police in June.

Crime is increasing the costs of running a business. Insurance premiums have gone up by about 20% this year in Manningham district, at the centre of the troubles. And the fear of crime, businessmen claim, is also deterring shoppers from coming to the city centre. Some businessmen report a drop in sales of 20% in the past few months.

Businessmen say the police are not protecting them. According to Mr Khan (the restauranteur), “they have no intention of doing anything about it”. The businessmen complain that the police have adopted too much of a “softly-softly” approach in Bradford for fear of provoking trouble. A recent report into race relations in the city by Sir Herman Ouseley, a former chairman of the Commission for Racial Equality, agrees. It found that Asian men in gangs were openly boasting that the police would not touch them for fear that they would riot. “People from all sections of the community resent the police for what they see as nothing being done against criminals. They collude with non-intervention.”

The police reject these claims, arguing that they do their job with “sensitivity”, and that they are working with “heavy workloads under enormous pressure”. Some 60 officers are still dealing with the aftermath of the riots. But they do not have much incentive to tackle the problem. Burglary, robbery and car-crime are among their “key performance indicators”, as set down by the Home Office, but attacks on businesses are not.

Perhaps it is time they were. Economic regeneration and inward investment are mostly what determine whether or not a city recovers from a bad time. There is not much of either going on in Bradford; nor is there likely to be until the city is safer for businesses.

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Conservative Party conference

Who said we don't like Europe?

Oct 11th 2001
From The Economist print edition

Nobody much was watching, but IDS did rather well

FOR Iain Duncan Smith, the new leader of the Conservative Party, it was just as well that the conference was a sideshow to events elsewhere. A harsher spotlight would have exposed what an odd, diminished crew he is now leading.

Compared with his predecessor, William Hague, Mr Duncan Smith is no orator. The applause from the audience after he gave his first conference speech was more dutiful than enthusiastic. But, despite a frog at times in his throat and the occasional stumble, he made a decent job of it.

With IDS, as he is universally called, what you see is what you get: a straightforward, right-wing ex-soldier whose abilities may be limited but who is determined and direct. He could easily be a party chairman in a shire constituency, which is perhaps why he goes down so well with Tory activists, who voted for him overwhelmingly in the leadership election.

For the first two-thirds of his speech, he was on military ground, where he feels at home. There were sideswipes at the Liberal leader, Charles Kennedy, for cavilling at the American call for its allies to back military action. “I have to ask what jaundiced views of America animate such people.” For IDS, it was a simple matter. “This war against terrorism is our war.”

A new balance needed, he said, to be struck between human rights and human safety. The Human Rights Act was an obstacle to protecting the lives of British citizens because it enabled terrorist suspects freely to enter the country and prevented the expulsion of those who threaten the life of a British prime minister. “When we cannot even extradite people accused of violence against America to the United States, then it is time to change the law,” he insisted to loud applause.

Then Mr Duncan Smith moved on to less familiar territory: domestic affairs. He knows that this is the ground he must make his own. The party is determined not to repeat the mistake it made at the last election of seeming to concentrate solely on its hostility to the euro.

In one rather smart move, Mr Duncan Smith managed both to distance himself from knee-jerk europhobia and to show that he was thinking hard about public services. He pointed to the example of Britain's European neighbours, claiming they “enjoy better hospitals and schools because they put the needs of their people before the demands of dogma.” The shadow cabinet, he said, had been instructed to set off on an extended European tour “to see why their public services are so much better than ours.”

The shadow cabinet will discover, as Mr Duncan Smith intends, that other Europeans are not trapped, as many Britons are, by a conviction that public services must be provided, as well as paid for, by the state. That would be a good lesson to bring home, which would fit with what remains of the party's ideology. But it will also discover that most European countries spend a great deal more on public services than Britain. That would not knit quite so well with the party's commitment to cut taxes and to reduce public spending as a proportion of GDP from 40% to 35%.

After its worst defeat for more than 50 years, the Tory party does not know where it is going. But, as John Redwood, former contender for the leadership and one-man awkward squad, pointed out at a fringe meeting here this week, “If the Tory party is not a tax cutting party, it is nothing.”

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The courts

Judge and jury

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The right to jury trial should be limited, says a review of the criminal courts

CRIMINAL courts, Sir Robin Auld considers gloomily, are only a last and limited resort for addressing society's woes—“a blunt instrument of social repair”. They could also, he thinks, be a good deal fairer and more efficient. In his gargantuan review of the criminal courts of England and Wales, commissioned by the government in December 1999 and published last week, Sir Robin, a senior appeal court judge, suggests plenty of sensible improvements. He also recommends radically diminishing the role of juries, and augmenting the power of judges.

De Tocqueville described the experience of jury service as a “peerless teacher of citizenship”; but around two-thirds of those summoned to serve on a jury bunk the lesson. The result is that juries are often disproportionately comprised of the old and unemployed. Sir Robin wisely wants to make them more representative—ending the current system of exemptions and excusals for all manner of professional people; emulating New York and other American states, where skipping De Tocqueville's lesson is much trickier; and punishing those who play truant.

But while wanting juries to be better constituted and prepared, he also wants to reduce drastically their caseload. Under the current system, criminal cases are tried either in magistrates' courts—which can hand down sentences of up to six months for a single offence, and which handle the vast majority of criminal cases—or before a jury in a Crown Court. But there are some intermediate offences, such as theft, which can be tried either way. The government has attempted, so far unsuccessfully, to abolish the right of defendants charged with such offences to choose how they are tried. Sir Robin criticises the government's mathematics and motives, but agrees as a matter of principle that the right to choose should be abolished.

Although he affirms the democratic importance of the jury system, his plans would prune it even more than the government's. In place of the current arrangement, Sir Robin proposes a new court system of three tiers—essentially the two existing courts, with a middle tier sandwiched in between, presided over by a judge and two magistrates. This tier would have jurisdiction over intermediate offences meriting prison sentences of up to two years. Lee Bridges, of the University of Warwick, estimates that, combined with the denial of choice, this innovation would deprive more than twice as many defendants of jury trials as would the government's proposals.

A judge, Sir Robin thinks, should also be able to dispense with juries in cases of serious and complex fraud, and try the case himself, assisted by two lay experts. More controversially still, he wants to eliminate “perverse verdicts”. These were more common when capital punishment was liberally applied; but, still, in a few cases—such as the acquittal last year of environmental protesters who destroyed a field of GM crops—jurors decide to judge the law as well as the defendant, or make a political point in spite of the evidence.

Sir Robin fulminates against such presumption, and proposes a range of mechanisms to deter it, including giving prosecutors the right to appeal perverse decisions. But as Michael Zander, of the London School of Economics, says, delivering the occasional perverse verdict is part of the jury's role in standing between the citizen and the sometimes overweening state.

Nostalgia about the jury system, as Sir Robin points out, tends to be misinformed. Trial by jury has evolved over time, and the right for some defendants to choose it dates only from 1855. Jury trials are costly, fallible and slow. But even if trial by jury is not as perennial a right as its supporters sometimes claim, it is still a valuable and popular one (except, perhaps among jurors), which his proposals would undermine. Even at a time when anxiety about civil liberties can seem self-indulgent, the government

should approach some of Sir Robin's ideas with caution.

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Money-laundering

Les mains sales

Oct 11th 2001
From The Economist print edition

A Frenchman dares to criticise Britain's financial system

ARNAUD MONTEBOURG, a crusading French socialist politician whose interests include President Chirac's financial affairs, does not mince his words. Switzerland's attempt to fight money-laundering, he said earlier this year, is nothing but a façade. Swiss bankers were appalled. Now it is the turn of the British to feel the lash of Mr Montebourg's tongue. The City of London, Gibraltar, the Isle of Man and Jersey, he writes in a report published this week, are sanctuaries for dirty money, including, possibly, that of Osama bin Laden.

Until very recently, many of Mr Montebourg's criticisms were justified. For years, banks, accountants and lawyers in Britain did little or nothing about trying to spot the criminals among their clients. Asking awkward questions of wealthy new prospects is, after all, bad for business.

In March, the Financial Services Authority (FSA) said it found that 23 British banks happily handled the money of the late Nigerian dictator, General Sani Abacha. Fifteen of them had “significant control weaknesses” in their anti-laundering rules, said the FSA. After the attacks on the World Trade Centre, the National Criminal Intelligence Service put the boot hard into the financial services industry: two-thirds of banks in Britain, it said, make no suspicious-transaction reports at all. Lawyers and accountants are even worse.

Now, though, the French denunciation looks rather outdated. In December the FSA will take on new powers, including the ability to inspect as a matter of routine how seriously banks are enforcing their anti-laundering rules. “We're getting a new role for a reason,” says a spokesman. “If there was a gap in the past, there won't be in future.”

A new Proceeds of Crime bill will give police the right to monitor any bank account which they think may be linked to terrorists, whether or not the source of the money is legitimate. Suspicious-transaction reporting requirements for banks, lawyers and accountants are to be tightened. And bureaux de change, a particular bugbear of Mr Montebourg's, will be subject to money-laundering regulations as they are in France and several other countries.

The report will probably be ignored by British bankers and regulators, not just because it was published only in French. The issue is too sensitive for one country's criticism of another to achieve much. Patrick Moulette, head of the secretariat at the Financial Action Task Force (FATF), the world's main anti-laundering body, believes that progress can be made only when judgments are made as part of a consensual process. “Combating money-laundering requires a collective response, not a national one,” he argues.

Privately, though, those in the business of combating money-laundering regret that the FATF cannot be as outspoken about certain countries' shortcomings as it would like. America and Canada fully obey only two-thirds of the FATF's 28 specific rules on money-laundering, far fewer than Britain, which avoids four. But the organisation still describes them in mostly glowing terms.

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Bagehot

That's enough loyalty

Oct 11th 2001
From The Economist print edition

May we have our politics back, please?

BEING at war against a pitiless terrorist enemy, instead of against one another, Britain's politicians have been on their best behaviour since September 11th. As when a dog walks on its hind legs, it is surprising to see them do it. But even Dr Johnson would admit that they do not do it well. And now it is time they stopped.

When the airborne terrorists struck the Pentagon and New York's twin towers, the shock of the atrocity brought normal politics to a halt. Tony Blair abandoned a controversial speech he had planned to deliver to the Trade Union Congress. The main political parties cut short their seaside conferences. Parliament has been recalled twice from its summer recess for emergency debates. On both occasions, dissent was muted, if not inaudible. After flying back to the Commons from the Conservatives' conference in Blackpool, Iain Duncan Smith, the party's new leader, gave a short and dignified speech endorsing everything Tony Blair had said and done so far.

It is right to be grave after a tragedy that claims thousands of lives. But in Britain's system, politicians who drench each other in dignity are not doing their jobs. That of Parliament is not to govern but to hold the government to account; and as a rule it does this best when it assumes the worst about the government's motives and competence. The job of the opposition is not to salute the government but to pounce on its every mistake, prick its every pretension, belittle its every success—and, above all, to offer an alternative. Of course there are times when it behoves the opposition to stress that it is “loyal”, meaning that it is not traitorous. Beyond that, however, too much prating about loyalty, even in war, damages democracy's health. Who now regrets that war was allowed to cut short the weak premierships of Asquith in 1916, Chamberlain in 1940 and Eden in 1957?

So far, dissent about the war has hardly surfaced in mainstream politics. At most, the parties have insinuated small differences of ideology and policy into the interstices of permissible debate. Charles Kennedy of the Liberal Democrats, has said that his support for America does not extend to the offer of a “blank cheque”, and that in the terrorist war's trade-off between security and civil liberty, his party would tend towards the side of liberty. Mr Duncan Smith has stressed the value of NATO, the danger to it of Mr Blair's plans for a “European army”, and the Tories' strengthened belief in the need for missile defences, about which Labour is ambivalent. There are the beginnings of a grumble on Labour's left about how far beyond Afghanistan the war might spread. But no big party (save Plaid Cymru, the party of Welsh nationalism) has spoken against the decision to wage war alongside America, and none is likely to pending a severe reverse in Afghanistan or a big terrorist attack on Britain.

Even if unity around the war effort is the right (and not just the risk-averse) stance for the political parties, it is hard to see why they should not fight as usual about everything else. The present outbreak of inter-party concord is anyway mostly a sham. It is not governed by a desire to raise morale on the home front: Britons can disagree with one another about railway privatisation, the euro and even the war's strategy without giving comfort to Mr bin Laden in his cave. It is governed by self-interest. The stifling of debate helps to silence Labour critics of Mr Blair's public-service reforms. As for the Tories, rallying around the flag is one of the few things that their new leader can do impressively while grappling behind the scenes with his broken party's unresolved divisions. If you think this too bleak a reading of political motives, consider the evidence of the callous memo from a Labour spin doctor, leaked this week but written while the World Trade Centre was still in flames, advising her minister that the televised immolation in New York made this “a very good day to get out anything we want to bury”.

The sooner normal political service is resumed the better. But there is a difficulty. Normal politics in Britain has come increasingly to depend on the person and office of the prime minister—an office from

which Mr Blair, travelling tirelessly around the world as George Bush's principal advocate and partner in the war against terrorism, is increasingly absent.

Every prime minister needs a Willy

If Mr Blair is indispensable to the war effort, and if Britain needs an active prime minister at home, why does he not delegate the running of the home front to a deputy? For many years, in both government and opposition, Margaret Thatcher leant heavily on William Whitelaw, a shrewd and loyal lieutenant who had no ambition to take her place. She once declared, without getting her own joke, that “Every prime minister needs a Willy”.

Mr Blair, alas, does not have one. His true deputy is Gordon Brown, the chancellor of the exchequer, who some say is already President Blair's executive prime minister. But so transparent is Mr Brown's appetite to succeed Mr Blair that any enhancement of his present formidable status would alarm fellow ministers determined to thwart him. Mr Blair's nominal deputy is John Prescott. But the deputy prime minister was given that title to appease New Labour's traditional left, not because anyone believes him remotely capable of standing in for Mr Blair. Though he retains his title, Mr Prescott has been parked since the last general election in a corner of the cabinet office, next to a door marked “exit”. In theory, Mr Blair could reach over the heads of his true and nominal deputies and give the helm to one of the cabinet's rising talents, such as David Blunkett, the home secretary. But this would look both to the media and to Mr Brown himself as though the prime minister was steering the succession away from his chancellor. Thanks to the internal rivalries of New Labour, a prolonged war could mean that Britain will have to make do with a part-time prime minister. It still deserves to have full-time politics.

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The Internet, untethered

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From The Economist print edition

The Internet is going mobile. To succeed, it must learn from the mistakes made in the fixed-line Internet boom, argues Tom Standage

NIGHT-TIME on the neon-lit streets of Tokyo's Shibuya district, and the scene seems like a vision of the future. Here are the colourfully illuminated skyscrapers and huge video billboards, there are the throngs of exotically clad teenagers. And everywhere there are people talking and typing into astoundingly advanced mobile phones—tiny devices that fold up like colourful make-up compacts, are incredibly light, and have small, vivid colour screens capable of displaying sophisticated graphics. Most important of all, these phones enable their users to access the Internet while on the move. In Japan, the Internet has gone mobile.

In this respect, say prophets of the mobile Internet, the scene in Shibuya is indeed a foretaste of the future. The convergence of the two fastest-growing communications technologies of all time—mobile phones and the Internet—will, they say, make possible all kinds of new services and create a vast new market as consumers around the world start logging on from Internet-capable phones. Market-research firms and consultancies predict that by 2004, the number of mobile-Internet users will rise to around one billion, from 200m today.

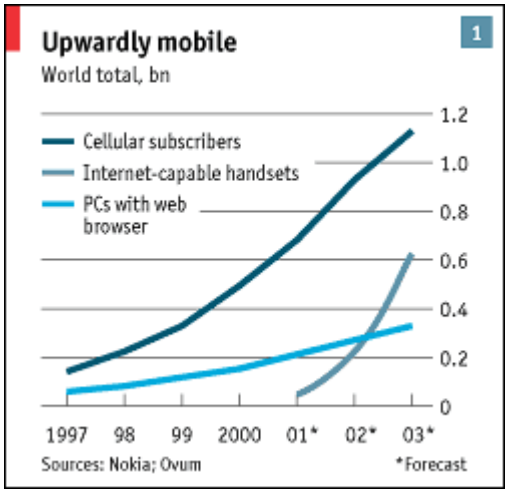
It was big numbers like this that prompted mobile-network operators around the world collectively to pay more than $100 billion last year for licences to operate “third-generation” (3G) networks (see article). Unlike existing second-generation (2G) networks, 3G systems are designed to handle data quickly and efficiently alongside voice calls, and are thus expected to be one of the key technologies that will underpin the mobile Internet. The enormous sums being spent on 3G amount to the largest bet in business history on the introduction of a new technology. The operators have been trying to justify this spectacular gamble with a torrent of hype.

But the downturn in the technology sector, and elsewhere in the world's economies, has cast a long shadow over 3G's future. The huge debts incurred by operators in buying their licences, and their need to cut spending in order to service their debts, were arguably one of the downturn's causes. On top of the cost of acquiring the licences, operators will have to spend another $400 billion or so to build their 3G networks, so they are teaming up to share infrastructure and reduce costs. There are also fearsome technical problems to overcome. This has delayed the start of 3G services: the world's first 3G network was launched in Japan on October 1st, five months late, and 3G networks in other parts of the world will arrive months, even years, later than originally planned.

At the same time, expectations have been scaled back. Operators are no longer talking of watching video clips on the train, or videoconferencing in a taxi; instead, they are concentrating on more realistic goals, such as using phones to access e-mail, download news and weather reports, and call up location-specific information. Meanwhile, many operators have already launched so-called “2.5G” networks—upgraded 2G networks that offer some of the benefits of 3G (in particular, an “always on” data connection) but cost a lot less. This means that 3G will not be the sudden miraculous transformation originally touted, but a gradual evolution from today's systems. And the truth is that a great deal is already possible with existing mobile networks.

Indeed, amid all the carnage in the technology sector, an

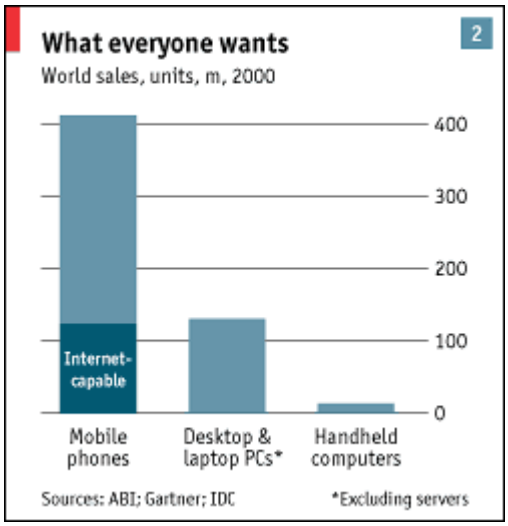
important transition is under way. Even allowing for the late arrival of 3G, it will not be long before the number of Internet-connected mobile phones exceeds the number of Internet-connected PCs. Nokia bullishly predicts that this will happen next year; Ericsson, another handset maker, says 2003; even pessimistic forecasts put the date at 2005. It will probably be 2.5G handsets, rather than 3G ones, that will overtake PCs to become the world's most prevalent Internet-access devices. But one way or another, phones will soon become the predominant means of access to the Internet.



The obvious recent analogy is with the explosive emergence of the fixed-line Internet five years ago. In many ways, the mobile Internet is at the same stage of development as the Internet was in 1995. There are hundreds of start-ups, and nobody really knows which technologies or business models will win, or what consumers or corporate users want. There are plenty of lessons to be learnt from the mistakes made on the fixed-line Internet. This survey will argue that heeding those lessons will be crucial if firms are to prosper on the mobile Internet.

A less obvious but more useful analogy is with the switch from the electric telegraph to the telephone in the last quarter of the 19th century. The telegraph, like the Internet, was a revolutionary communications technology that transformed social and business practices, but it could be used only by skilled operators. Its benefits became available to the public at large only when the telegraph evolved into the telephone—initially known as the “speaking telegraph”. The Internet is still in a telegraphic stage of development, in the sense that the complexity and expense of PCs prevents many people from using it. The mobile phone thus promises to do for the Internet what the telephone did for the telegraph: to make it a truly mainstream technology.

Because it used the same wires, the telephone was originally seen as merely a speaking telegraph, but it turned out to be something entirely new. The same mistake is already being repeated with the Internet. Many people expect the mobile Internet to be the same as the wired version, only mobile, but they are wrong. Fixed-line web pages will not fit on to phones or handheld computers. Instead, the mobile Internet, although it is based on the same technology as the fixed-line Internet, will be something different, and will be used in new and unexpected ways. It will rely on content and technology from the Internet, but instead of the leisurely browsing and searching familiar from the PC, it will concentrate on sending and receiving timely, relevant nuggets of information. Meanwhile, of course, the Internet in its current form will still be around.



The term “mobile Internet” itself is problematic. “Mobile data services” might be more like it. Other names that are bandied about include “the wireless web”, “mobile e-services” and “mobile online services”. But this survey will refer to the emerging mobile data environment as the “mobile Internet”, even though with the benefit of hindsight it may prove to be as much of a misnomer as “speaking telegraph”. One attraction of the term is that the word “Internet” technically refers to a network of networks, and that is exactly what the mobile Internet will consist of. It would be a mistake to equate the mobile Internet with 3G and assume that, because 3G is in trouble, other mobile-Internet services are too. Instead, there will be many overlapping and interconnected wireless networks. There will also be a variety of access devices, including laptops, handheld computers and other, as yet undreamed of, gizmos. Different networks and devices will be used in different situations by different kinds of users in different parts of the world. But it seems clear that the Internet-capable phone will predominate as the mobile device of choice.

Combining the Internet with mobile phones will pose technical, business and cultural challenges. For a start, there is a clear conflict of attitudes between Internet and mobile-phone users. Internet users expect things to be free, and are prepared to accept a certain degree of technological imperfection. Mobile users are accustomed to paying, but expect a far higher level of service and reliability in return. Those on the Internet side of the fence complain that wireless firms don't really understand data networking; those on the wireless side complain that Internet technology is flaky.

But the differences between these two worlds also present an opportunity. Content providers see the mobile Internet as a way to start charging for their wares. Wireless-network operators see themselves as potential gatekeepers to the mobile Internet, and may be in a position to grab a share of online commerce revenues, which fixed-line Internet-access providers have failed to do. Hardware and software companies see all sorts of new opportunities in products to knit the Internet and mobile networks together. In short, the mobile Internet is a chance to build a new network, and get it right this time—by learning from the mistakes made by all those failed dotcoms.

The biggest gamble in business history; control of a vast new medium; the opportunity, at last, to monetise the Internet: clearly, a great deal is at stake. Some say it is all just wishful thinking. But in many parts of the world—not only Japan—millions of people are even now using phones and other handheld devices to communicate on the move. All over the globe, the foundations for the shift to more advanced services are already in place.

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Generation game

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From The Economist print edition

Count to three

FIRST-GENERATION (1G) mobile phones, which have been around since the 1970s, use analogue technology to transmit voice calls. Sound quality is generally poor, use of radio spectrum is inefficient, and calls can be intercepted quite easily. Of the world's 800m mobile-phone users, around 70m, mostly in the developing world, have 1G phones.

Second-generation (2G) mobile phones use digital encoding. Communication between the handset and the base station takes the form of an encrypted data stream, making eavesdropping almost impossible. As well as voice calls, 2G phones can also send and receive data, so they can provide limited data services such as text messaging and Wireless Access Protocol (WAP) browsing. Most mobile phones in use today are 2G.

Enhanced second-generation (2.5G) phones, which have recently become available, extend 2G technology to offer improved data capabilities, such as higher transmission rates and always-on connections, so these phones can support more advanced data services.

Third-generation (3G) phones will offer high-speed, always-on data connections, as well as support for applications such as videotelephony and advanced data services with full Internet access. 3G networks are also designed to support large numbers of users more efficiently than 2G networks, to allow for future expansion.

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Peering round the corner

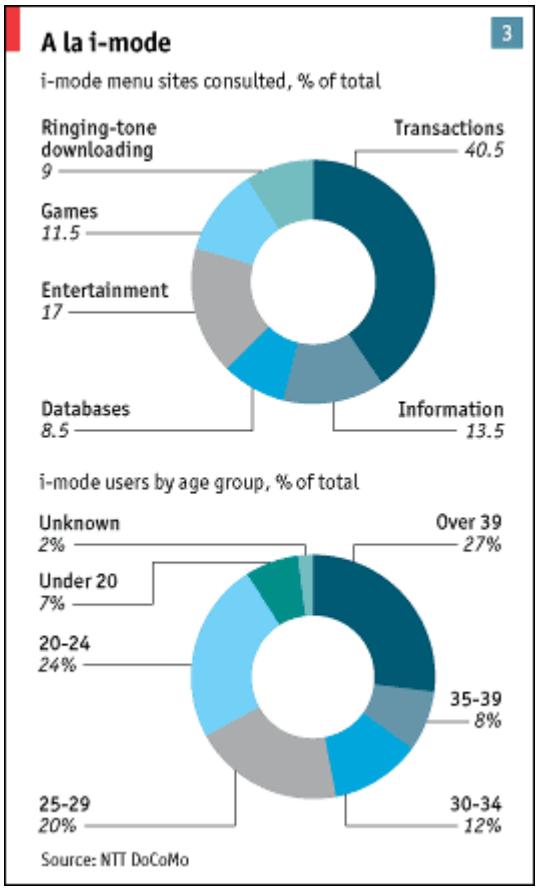
Oct 11th 2001
From The Economist print edition

The shape of things to come is already becoming apparent, if you know where to look

WILLIAM GIBSON, a science-fiction writer, once observed: “The future is already here–it is just unevenly distributed.” If so, then the future of the mobile Internet is particularly highly concentrated on the 29th floor of the gleaming Sanno Park Tower Building in Tokyo. This is where executives from the world's mobile-phone companies go to see the latest gadgets from NTT DoCoMo, Japan's dominant mobile operator, and the unquestioned global leader in the fusion of mobile phones with the Internet.

The firm's claim to fame is the runaway success of its i-mode service, which pipes cut-down web pages on to mobile phones with small colour screens. DoCoMo, whose name is a play on the Japanese word for “anywhere”, has 60% of the Japanese mobile-telephony market. Over two-thirds of its 37m mobile subscribers have also signed up for i-mode, which was launched in February 1999. This allows them to use special i-mode phones to send and receive e-mail, read the news, access weather forecasts and horoscopes, and download ringing tones and cartoon graphics from nearly 50,000 i-mode-compatible websites. The most advanced i-mode phones double up as music players and can download and run small pieces of software, including games. Other popular uses for i-mode include mobile banking, stock trading and reserving airline tickets (see chart 3).

This is impressive from a technological point of view, but what is even more remarkable is that i-mode's 27m users are prepared to spend money on these services. On top of a monthly charge of ¥300 ($2.50) to access the i-mode service, they pay ¥2.4 (2 cents) for every kilobyte (thousand bytes) they download. In addition, around 500 DoCoMo-approved i-mode sites are subscription-only, requiring users to pay monthly fees of up to ¥300 each; DoCoMo collects these fees as part of the monthly phone bill, takes 9% commission, and passes the rest to the sites' publishers. About 50% of i-mode users subscribe to one or more of these sites. And despite claims that i-mode appeals only to teenage girls, half of all i-mode users are 30 or over, and a quarter are over 39 (see chart 3).



All these data whizzing around produce extra revenue for DoCoMo, and have other benefits too. The company has found that i-mode users are more lucrative than other subscribers. On average, they spend 15% more on voice calls than non i-mode subscribers, and generate 25-30% more revenue overall. They are also far less likely to switch to other operators.

Most important, as competition forces down revenue from voice calls—from an average of $100 per subscriber per month in March 1997 to $65 in March 2001—data revenue amounting to an average of $17 per user per month helps to make up the difference. Operators and content providers the world over are keen to find out how they can emulate i-mode's example.

Those who have made the pilgrimage to DoCoMo's 29th-floor demonstration room over the past few months have been rewarded with what is, to most people in the industry, a wondrous sight: 3G phones that actually work. DoCoMo originally intended to launch its 3G service, called FOMA (for “freedom of multimedia access”) in May, but teething problems with the new technology forced the company to impose a five-month trial period, and delay a full launch until the beginning of this month. FOMA now offers i-mode access at far higher speeds than existing phones, as well as snazzy new features such as videotelephony and the ability to use data and voice services at the same time.

DoCoMo's 3G phones look and feel much like its standard i-mode phones, though the higher data rates mean they are hotter in operation, and their batteries run down much faster; they need to be recharged every day. But look more closely at one of the Panasonic models, and you will notice that it has two green “call” buttons, and a small rotating aperture in the hinge between the phone's two halves. The aperture is a camera, and the second “call” button is for making video calls. The phone is held at arm's length, and the camera can either point at the user, or be rotated 180 degrees to transmit what the user is seeing. The quality of video calls is impressive, at least to anyone used to the grainy moving postage stamps that pass for video on the Internet.

However, there is more to the mobile Internet in Japan than DoCoMo and i-mode. Japan's other two mobile operators, KDDI and J-Phone, have their own i-mode-like services. J-Phone (in which Britain's Vodafone, the world's largest mobile operator, has a big stake) is every bit as innovative as DoCoMo. Although it has yet to launch its 3G network, this summer J-Phone was the first Japanese operator to launch a phone with a built-in still camera, which allows users to send photos. J-Phone has also pioneered “location-based” services, which allow users to call up information relevant to their location.

Why has the mobile Internet been such a success in Japan, and can that success be duplicated elsewhere? Certainly Japan is a special case in many ways. For a start, PC penetration is low for cultural reasons. It used to be regarded as demeaning for managers to have PCs on their desks; typing was for secretaries. In addition, NTT, the incumbent fixed-line telephone company, charged high rates for dial-up Internet access. And the Japanese have traditionally been enthusiastic about small technological gadgets.

Why Japan has it made

There are other factors at work, too. The three Japanese mobile operators each operate incompatible proprietary systems. DoCoMo users, for example, cannot send short text messages to KDDI users. J-Phone's location-based services are available only to J-Phone subscribers. And if you want to switch from one operator to another, you have to buy a new phone, since Japanese handsets are operator-specific. This absence of open standards may seem old-fashioned to foreigners, but it has been a key factor in getting the mobile Internet off the ground in Japan. When a Japanese operator wants to launch a new service, such as picture messaging or videotelephony, it can specify in detail how that service will work, ask manufacturers to build the appropriate handsets, and ensure that these are available when the service is launched.

Operators in other parts of the world are too numerous to be able to boss the handset makers around in this way. Instead, they face a chicken-and-egg situation. There is no point in their launching an innovative service unless handsets to support it are available; but until such a service has been launched, manufacturers have no reason to produce handsets that support it. This explains why, for example, handsets with colour screens are still a rarity in Europe, though they are commonplace in Japan. Colour screens make phones more expensive, and consumers will not pay more for them unless there are compelling services that use colour. No such services exist, so nobody buys colourhandsets, so there is no reason to develop colour services.

Even so, it should be possible to make the Japanese model work in other countries. DoCoMo has great hopes for establishing i-mode as a global standard, and has formed a number of alliances with companies including AT&T and AOL in America; it also owns minority stakes in mobile operators in Europe and Asia. But its attention is currently concentrated on getting 3G off to a good start in its home market, so its plans to launch i-mode elsewhere have not got very far yet.

Besides, the real reason for i-mode's success is not so much the technology as the business model. By giving content-producers a means to charge users, i-mode ensures that there is plenty of content available; indeed there is a growing waiting list of content-providers awaiting DoCoMo's approval for their sites. That wealth of content attracts users who, in turn, attract more content. The result is a virtuous circle. Another important factor is the management of expectations: users understand that i-mode is different from logging on from a PC.

Textbook success

I-mode or no i-mode, the use of phones to send short text messages has grown explosively. The Japanese call them *oyayubizoku* (the thumb tribe), but the sight of people walking down the street frantically clicking at their handsets has also become a familiar sight in many other countries, notably in Europe and some parts of Asia. Some schoolchildren, forbidden to use the phones in class, have taught themselves to input text by touch alone, so that they can send messages while keeping their phones hidden. In the Philippines, the country where text messaging is most popular, the use of the technology by protesters is credited with helping to overthrow the country's former president, Joseph Estrada.

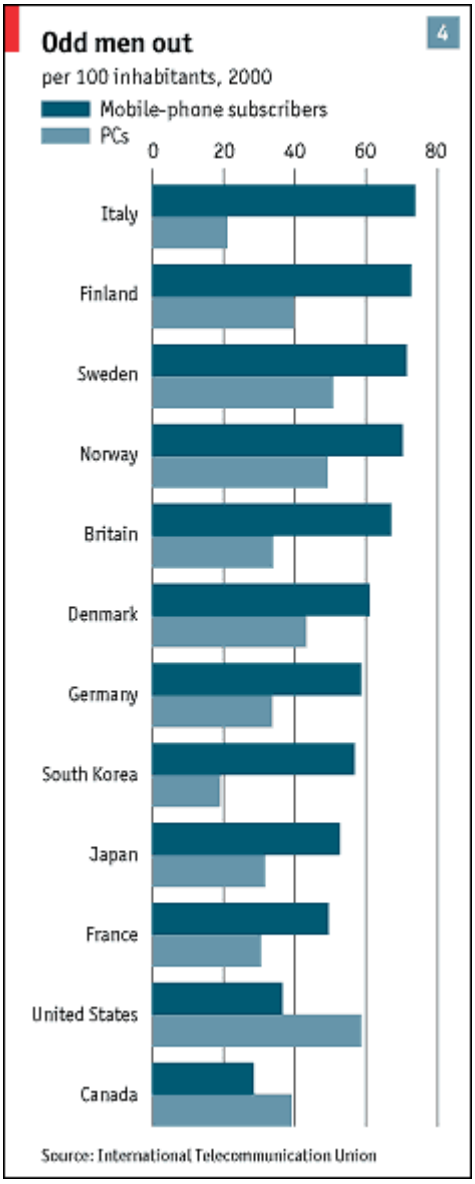
Text messaging is a booming and hugely profitable industry; globally, over 30 billion messages are now sent each month, bringing in over $30 billion a year in revenue for operators, according to figures compiled by Simon Buckingham of Mobile Streams, a consultancy based in Newbury, England. In some parts of the world, text messaging accounts for 10% of operator revenues.

Normal text messages are limited to 160 characters, costing an average of 10 cents each to send, but text messaging can be used to do more than just send quasi-telegrams to other people. Premium-rate text messages can also be used to request new ringing tones and logos. In Finland, it is possible to buy soft drinks and chocolate bars from some vending machines using text messages. In some Scandinavian countries text messages can be used to pay parking or car-wash charges. Increasingly, text messaging is being integrated with the Internet to allow messages to be sent to and from websites or desktop PCs. Hence the claim by Peter Vesterbacka of Hewlett-Packard in Espoo, Helsinki's high-tech suburb, that Scandinavian countries, along with Japan, provide “a partial crystal ball” for the future of the mobile Internet.

By contrast, Wireless Access Protocol (WAP), the nearest thing to i-mode outside Japan, has dismally failed to catch on. It is used by fewer than 10% of mobile subscribers in Europe, and accounts for less than 0.5% of operator revenue. WAP's failure has a number of causes, not least an excess of hype. An infamous advertising campaign launched in Britain by BT Cellnet used fancy computer graphics of a digitised figure whooshing around on a surfboard. The reality of accessing the Internet from a mobile phone, users soon discovered, was far less glamorous.

WAP, which displays cut-down web content on phones, is painfully slow: just establishing a connection takes up to half a minute, and downloading anything requires the patience of a saint. There are numerous WAP versions that are not fully compatible. But worst of all, there is very little content, because there is no way for content-providers to charge for it. Operators collect a per-minute fee for WAP usage, and some of them pay content providers to produce material to encourage traffic, but there is no virtuous circle of the i-mode sort. WAP is crap, goes the industry refrain. But in essence the problem is the business model, not the technology, particularly now that 2.5G networks are speeding up the service.

When it comes to the adoption of mobile data, the odd country out is not Japan but America. The United States and Canada are the only countries in the world where PCs are more numerous than mobile phones; everywhere else the reverse is true (see chart 4).



The American exception

America's enthusiasm for PCs, and lack of enthusiasm for mobile phones, is due to a combination of factors, but mainly to the relative prices of fixed and mobile calls. In Japan, expensive access to the fixed Internet drove users to mobiles; in America it was mobiles that priced themselves out of the market. Local calls are free, and PCs are cheap. Mobile phones, on the other hand, suffer the huge drawback that users are charged to receive calls, so Americans tend to leave their mobile phones switched off to avoid having to pay for unwanted incoming calls. Mobile network coverage is patchy and rates until recently were high. So teenagers who want to keep in touch with their friends are given their own phone line, a PC and a dial-up account with AOL, the world's largest Internet-access provider. Soon they are happily sending and receiving instant messages through their PCs.

Their counterparts elsewhere in the world, in contrast, are brandishing mobile phones and sending text messages. Mobile phones have become even more appealing to teenagers in Europe since the advent of “pre-paid” phones, which can be replenished with vouchers on sale at newsagents and corner shops. Pre-payment, which originated in Italy to exploit a tax loophole, means that even people without bank accounts (such as children) can have mobile phones. It also enables users to control their spending.

Sending text messages is cheaper than making voice calls, which helps to explain their success. According to figures from Gartner, 47% of Swedes and 39% of Italians use text messaging, compared with 2% of Americans. But even in America, lower prices and better co-operation between operators are now helping text messaging to take off.

Another oddity is that handheld computers, which are essentially cut-down PCs, are also far more popular in America than elsewhere. These devices—notably Compaq's iPaq, and the handhelds made by Palm and Handspring—are far more expensive than mobile phones and lack wireless connectivity as standard, though they have bigger screens and more processing power. Americans widely perceive

wireless-enabled versions of such devices, rather than Internet-capable mobile phones, as the logical means of accessing the Internet while on the move.

The split between America and the rest of the world is apparent in other ways, too. Because PCs are so popular in America, people there like to think of the mobile Internet as simply a mobile version of the PC-based Internet. This has fired their enthusiasm for a wireless networking standard called 802.11b, or Wi-Fi, which allows suitably equipped laptops within a few hundred feet of a base station to access the Internet. Wi-Fi coverage is spreading fast in many American offices, universities, hospitals, schools and airports, and its advocates claim that it could even do away with the need for 3G networks (see article).

Joe Manget, an analyst at Boston Consulting Group, thinks American enthusiasm for Wi-Fi can be explained partly by another cultural difference with the rest of the world. In Europe and Asia, he notes, many people commute to work on public transport, and like to peck at their mobile phones while they are on the move. In America, on the other hand, people commute in cars, which rules out the use of wireless handheld devices. Instead, they want wireless access for their laptops when waiting around in places such as hotel lobbies and airport lounges.

Martin Dunsby of Deloitte Consulting points to yet another difference. Thanks to general enthusiasm for information technology, American firms are far more likely to have adopted customer-relationship management and enterprise-resource-planning systems (which keep track of customers and inventory, respectively) than companies in other countries, and now want to extend those systems to wireless devices. So in America it is the corporate market that leads the mobile Internet, says Mr Dunsby, whereas elsewhere it is the consumer market.

But whatever the differences, the fact remains that the mobile Internet, in one form or another, generates enthusiasm across the developed world. As with the Internet in 1995, it is clear that both consumers and businesses would like to adopt this new technology over the next few years. Last time round many of the firms that rushed to exploit the demand for everything to do with the Internet got things seriously wrong, as the demise of the dotcoms shows. The builders of the mobile Internet evidently believe they can avoid making the same mistakes. So what makes wireless different?

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Cat among the carrier pigeons

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Which of several competing standards for wireless data transmission will prevail?

"YOU see, wire telegraph is a kind of a very, very long cat," explained Albert Einstein. "You pull his tail in New York and his head is meowing in Los Angeles...And radio operates exactly the same way: you send signals here, they receive them there. The only difference is that there is no cat."

The difference between the fixed-line Internet and the wireless version is of the same order, only there will be several overlapping kinds of non-cat. On the Internet, information travels around in packets of data, which can be sent from one place to another using a variety of technologies. The one that is currently causing the most excitement in America is based on a standard called 802.11b. This is such a terrible name that the industry has started calling it Wi-Fi (for wireless fidelity, which is not much better).

To set up a Wi-Fi network in your home or office, you simply buy a base station, plug it into a phone socket or a high-speed Internet connection and hang it on a wall. Using unlicensed radio spectrum, the base station communicates with computers within 45 metres (150 feet) or so, provided they are equipped with a suitable plug-in card. It also enables the computers to communicate with each other. In effect, Wi-Fi lets you flood a building with wireless connectivity. This has a number of advantages. It is often cheaper and easier to link several PCs together wirelessly than to run messy cables all over the place.

Using Wi-Fi is astonishingly liberating. Home users quickly discover the joys of picking up their e-mail in the garden. Offices and university campuses have also been quick to adopt the technology, which allows users to keep information at their fingertips during meetings and seminars. Companies are deploying Wi-Fi in warehouses, to link portable computers to inventory systems. Wi-Fi "hotspots" providing free access have been springing up in airport lounges, hotels and coffee shops. Scandinavian Airlines is testing the technology as a convenient way to provide Internet access within airliners, without the need to run cables to every seat. In big cities including San Francisco, London and Seattle, enthusiasts are building "guerrilla networks" in an attempt to provide blanket Internet coverage; firms such as MobileStar and Wayport in America and Jippii in Europe are doing the same, but on a commercial basis.

Is Wi-Fi a killer?

Work is already under way on new versions of the 802.11b standard that will improve the range and transmission speed of Wi-Fi equipment. Some analysts have suggested that Wi-Fi might kill off the high-speed mobile networks, such as the third-generation (3G) networks now being built around the world.

This seems highly unlikely. For a start, Wi-Fi is designed for use with fully fledged computers, and transmits high-speed data over short distances. 3G is slower, but was designed to handle a far larger number of users, and to work with small, handheld devices over longer distances. Wi-Fi is intended to provide coverage in hotspots; 3G is intended to provide blanket coverage. Wi-Fi cannot be used for voice calls, and currently consumes too much power to be used in phones or small handheld computers for more than a couple of hours. It also has serious security shortcomings; its built-in encryption standard has been shown to be flawed. In short, although computer users will happily use Wi-Fi to access the Internet from their laptops when it is available, they will still need a cellular connection if they want to roam beyond Wi-Fi hotspots or make voice calls.

All this means that the technologies are widely seen as complementary rather than competitive. Many equipment vendors, such as Nokia, Nortel and Ericsson, make both cellular and Wi-Fi equipment. A recent report from Analysys, a consultancy based in Cambridge, England, suggested that mobile-network operators should consider building Wi-Fi networks alongside their 3G networks and facilitate seamless switching between the two.

In short, multiple standards will prevail: Wi-Fi, 3G, 2.5G networks, and specialist data-only networks such as Mobitex. Bluetooth, another wireless standard, is intended to allow devices such as handheld computers and printers, or phones and headsets, to communicate over very short distances. And already there is talk of 4G networks. The mobile Internet will exploit a tapestry of wireless networks, all of which will coexist without a tangled cable in sight—or indeed a cat.

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Why mobile is different

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For a start, people are used to paying for it

HOW do you make money on the Internet? In the late 1990s, this was the question on everybody's lips. The answers bandied about included “building communities”, “ensuring stickiness”, “B2C”, “B2B” and many others. Buzzwords came and went, and eventually nearly everyone went bust. The problem was that advertising revenue was insufficient to keep most sites running, and there was no standard way to charge for things on the Internet. There still isn't. Getting people to type their credit-card details into a web page raises security concerns, and makes purchases of less than a few dollars impractical. A handful of sites selling books, CDs, flights and holidays look as though they will survive. But most news and content sites are losing money, and many are now trying to introduce subscription fees. Many more have folded. Why should things be any different on the mobile Internet?

Mobile is different from the fixed Internet in three important respects. First, a mobile phone is a far more personal device than a PC. It is likely to be used by only one person, who will probably have the phone with him for most of his waking hours. Whereas e-mail messages go to a machine sitting on a desk, text messages go directly to the mobile phone's user. Often the network operator knows exactly who that user is, including his name and address. In order to route calls to and from the mobile, the network operator also needs to know where it (and therefore probably its user) is at all times.

Second, network operators can determine what menus and services appear on their users' phones. Whereas on PCs users have lots of scope to play around with the settings, on mobile phones all they can easily change is the ringing tone and the screen logo. The ability to set the default portal—the starting page that users see when they connect to the mobile Internet—is a big advantage, because it allows operators to act as gatekeepers.

This will cost you

Last, and most important, people know that using mobile phones costs money, and there is a mechanism for the network operator to charge them for that use. What is more, users seem prepared to pay a “mobility premium” to do things while on the move. Sending an e-mail or instant message over the Internet from a PC is essentially free; sending a text message from a phone costs an average of 10 cents, but users are prepared to pay because they regard it as good value, or because it makes their lives easier. And even when text messaging is more expensive, people still use it. In some places, sending a text message home while “roaming” in a foreign country can cost as much as *euro*1 (92 cents). Such charges are currently under investigation by the EU's competition commission. But compared with the cost and hassle of buying a postcard and a stamp, this still seems reasonable enough to many people.

In short, if you have a mobile phone, the network operator knows who you are, where you are, can direct you to the portal of its choice, and can charge you money. This is a very different world from that of the fixed Internet.

Mobile has some drawbacks, of course. Mobile devices have more limited screens and keyboards than PCs, and slower connections. Also, says Niklas Savander of Nokia, mobility makes people much more impatient. Researchers have found that a five-second delay to access something on an Internet-capable phone seems far longer to users than a five-second wait to call up a web page. “With the same response

time, people rate mobile as slower," he says. "So we have a slower connection, but users want a faster response."

For me, here, now

But the combination of personalisation, location and a willingness to pay makes all kinds of new business models possible. Tomi Ahonen, head of 3G Business Consulting at Nokia, gives the example of someone waiting at a bus stop who pulls out his Internet-capable phone to find out when the next bus will arrive. The information sent to the phone can be personalised, reflecting the fact that the user's location is known, and perhaps his home address too; so bus routes that run from one to the other can appear at the top of the list, saving the user from having to scroll and click through lots of pages and menus. A very similar service, which allows users to find out when the next bus is due by sending a text message from a bus stop, is already available in Italy.

Would-be providers of mobile Internet services cannot simply set up their servers and wait for the money to roll in, however, because the network operators—who know who and where the users are, and control the billing system—hold all the cards. This has changed the balance of power between users, network operators and content providers. On the fixed Internet, the network access provider acts as a "dumb pipe" between the user's PC and, say, an online bookstore or travel agent. The access provider will not know how the connection has been used, and there is no question of claiming a commission. Mobile network operators, on the other hand, are in a far more powerful position. "Wireless is a smarter pipe," says Chris Matthiasson of BT Cellnet. This means that operators are much less likely to be disintermediated.

Having avoided one mistake made on the fixed Internet, however, wireless operators may be tempted to make another, by setting up "walled gardens" of services and content. In theory, restricting users to a handful of approved services will enable operators to capture a much larger chunk of the expected bonanza in data revenues. In the 1990s, online services such as AOL, Compuserve and Prodigy operated on the walled-garden principle; but as soon as one of them offered unfettered Internet access, the others had no choice but to follow suit. The walled-garden model will turn out to be just as unsustainable on the mobile Internet, because users get annoyed by it.

Furthermore, unlike Internet access providers, wireless operators charge by usage, either for every minute spent online, or for every byte downloaded. This means they make money on transporting data come what may, so it makes sense to offer users the widest choice of content possible to encourage them to run up transport charges. That is how i-mode works; the vast majority of DoCoMo's data revenues come from transport, not the sale of content (though the firm does take 9% on the sale of other providers' content). A typical i-mode user spends ¥2,000 (about $17) per month on data-transport fees, and only ¥400 on content subscriptions.

Operators therefore generally offer a selection of approved services through their own chosen portal, and also give subscribers the option of going elsewhere. This is what AOL does with its dial-up Internet service; it offers services such as instant messaging, chat-rooms and e-mail, as well as access to the web. But surveys show that most users still spend most of their time within what used to be AOL's walled garden. The best way for operators to keep users within their walled gardens, says Katrina Bond of Analysys, is to offer attractive services. The fact that operators know who and where their users are—and may be able to keep this information to themselves—can give their home-grown or approved services a valuable advantage.

The upshot is that the operators need decent content and services to drive traffic; and the content providers need the co-operation of the operators if they are to charge for their wares. A number of business models have emerged to govern the relationships between the two.

Show me the money

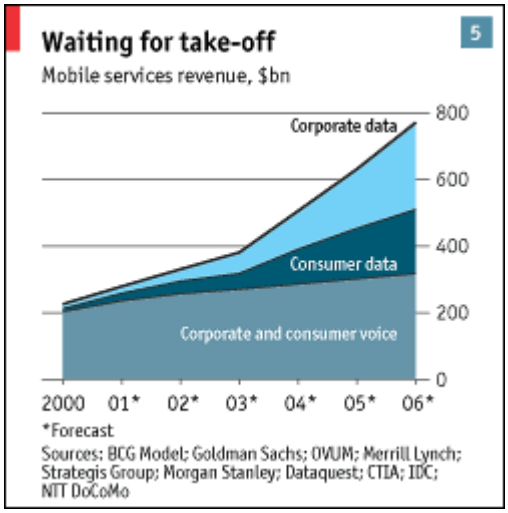
The simplest one of these involves sharing revenues from text messages. Lycos, a web portal, provides a service that allows PC users to send text messages from a web page and receive the replies on their PCs. The effect is to stimulate text-message traffic between mobile phones and PCs. The PC users do not pay to send messages, but the mobile users do; and through agreements with mobile operators, Lycos gets a cut. There are other services, such as mobile games, that encourage mobile users to send text messages; the content provider gets a share of the extra revenue generated. Sometimes the operator

also charges for the messages at a higher rate.

Another model involves the use of premium-rate text messages as a means of charging for one-off lumps of content, such as ringing tones, logos or horoscopes. Users send a text message to a special number, are charged accordingly, and have the content delivered in the form of a text-message reply.

More elaborate is a model sometimes called “reverse billing”, in which services are charged directly to the user's phone bill. In effect, the operator bills the user on behalf of the content provider, and then hands over the money.

In theory, reverse billing could be used as a means of payment for online commerce; a book, CD or cinema ticket could be charged directly to the user, as though it were an expensive phone call. And since mobile operators are used to handling a large number of small transactions, their systems can handle such transactions at around a tenth of the cost of a bank or credit-card transaction. This means that micropayments, which have never taken off on the fixed-line Internet, are feasible on the mobile one.



But users may prefer to pay lumpy subscription fees rather than a small charge for every morsel of information they access. Following the example of i-mode, whose sites work on monthly subscription fees, T-Motion, a mobile portal owned by Deutsche Telekom, has decided to try that model for WAP content, starting from November 1st. Subscribers to its T-Motion Plus service will pay *euro*10 ($9) a month for a bundle of free ringing tones and text messages, plus news, weather, financial updates, sport reports and games; this revenue will be split 50/50 with the content providers. T-Motion will track the popularity of the content, and will replace the least popular services every three months. With this model, the paid-for services cannot be given away free on other portals, or users will not be prepared to pay for them; the effect is to produce a walled garden of sorts, with premium services that only subscribers can access.

The most radical model is the “mobile virtual network operator”, or MVNO, in which a network operator acts as a wholesaler of airtime to another firm, which then markets itself to users just like an independent operator with its own network infrastructure. Virgin Mobile, a British mobile operator, is in fact an MVNO that resells voice and data airtime on the network belonging to another operator, One2One. The MVNO allows content providers to get their hands on transport fees, but operators feel ambivalent about the concept. On one hand, MVNOs can brand themselves to appeal to a wider range of customers, and thus boost overall use of the network; but on the other, MVNOs turn network operators into dumb pipes, giving them a smaller piece of the action. For the time being, most operators have chosen to deal with customers direct, rather than become wholesalers to MVNOs.

In various combinations, all of these models are in use now, but operators are still struggling to implement new billing systems. Most operators, says Nokia's Mr Savander, have between 20 and 40 separate billing systems to handle different kinds of services; one has 54. Software firms are competing to offer consolidated billing systems that will support any or all of these business models.

Which model will prove most successful remains to be seen, but there is certainly money sloshing around on the mobile Internet. Unlike on the fixed-line Internet, people are prepared to pay for content and services they really want. But what exactly might those be? As on the fixed Internet, there are two distinct markets: consumer and business. Although it is still early days, there are already signs of a “killer application” in each.

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Looking for the pot of gold

Oct 11th 2001
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What do consumers want from the mobile Internet?

WAY back in 2000, in the heady days before the dotcom crash, it all looked so easy: to make money from the mobile Internet, you simply created a mobile version of what worked on the fixed-line Internet. The vogue at the time was for business-to-consumer e-commerce, so the obvious target was mobile e-commerce, or m-commerce. Surely anything that could be sold over the conventional Internet to PC users could be sold over the mobile Internet to mobile subscribers. And because mobile users have their phones with them at all times, they might be expected to do more shopping than stationary customers. Best of all, since the mobile operators have a firm grip on their users, and know about things like billing, they should be able to claim a piece of the pie that eluded the fixed-line Internet-access providers.

In March 2000, just before the dotcom bubble burst, Jeff Bezos of Amazon, the leading online retailer, predicted that by 2010, all of his firm's customers would use wireless devices to make purchases. Describing m-commerce as “the most fantastic thing that a time-starved world has ever seen”, he predicted that it would change the way people shop, since they would be able to make impulse purchases anywhere, at any time. Within five or ten years, he claimed, “almost all of e-commerce will be on wireless devices.” Analysts queued up to make rosy forecasts of m-commerce revenues. With such a bonanza apparently around the corner, is it any wonder that mobile operators paid so much for those 3G licences?

But as the Nasdaq crashed and the dotcoms started going under, it became apparent that making money was hard enough even on the conventional Internet, where the technology is mature; the prospect of buying things on phones, with their tiny screens and keyboards, suddenly seemed far-fetched. Surveys showed that consumers found the reality of m-commerce hugely disappointing. Horror stories abounded: one trial found that it took over 40 minutes to order a book by phone; making a booking on one mobile hotel-reservation system required 37 clicks.

Users paying by the minute to access the mobile Internet were not prepared to put up with that. Research carried out by Boston Consulting found that during 2000, one-third of early users in Europe abandoned m-commerce after only a few tries. And a worldwide survey by A.T. Kearney found that the number of mobile users who said they intended to use their phones for m-commerce fell from 32% in June 2000 to 4% in June this year.

Many of the consumers' concerns, such as security and privacy, and difficulty with navigation, are reminiscent of worries in the early days of e-commerce, and may eventually be overcome. But there are broader problems with using handheld devices for shopping. Compared with PCs, which have large colour screens, handheld devices are hopeless for browsing. Scrolling through lists is cumbercome, and features and prices are hard to compare. Moreover, there seems little point in making an impulse purchase of a book or CD if it will then have to be delivered by post. Rather than spend ages pecking at a phone keyboard, why not wait until you get home and order in comfort from your PC? “The unique selling point is mobility,” says Declan Lonergan, an analyst at Yankee Group. M-commerce should not try to compete with e-commerce, he says, but should stick to sales of small-value mobile items, such as cinema tickets or paying for parking, that people are likely to want while on the move.

Location, location, location

People may not want to buy things by phone, but they are more enthusiastic about paying for information, as the success of downloadable ringing tones and logos demonstrates. Furthermore, focus-group research carried out by Nokia found that users expect purchases on mobile devices to depend on where they are, rather than the desire to buy a particular item. The buzzword now is “location-based services”. One helpful factor has been American legislation that requires operators to be able to pinpoint

the position of any mobile phone from which an emergency call is made, prompting operators to add positioning technology to their networks and handsets. The commercial possibilities of the technology are beginning to cause a lot of excitement.

Even without pinpoint accuracy, existing networks can already locate a user within a particular cell (the area covered by a mobile-network base station). In urban areas, such cells are quite small, so location-based services are possible even now. A host of firms are now offering location-based services such as traffic and weather reports, driving directions, travel and entertainment information and restaurant recommendations. Many of these firms have established partnerships with operators, which control access to the location information; others have done deals with infrastructure providers, so that operators can buy support for location-based services off the shelf.

Early examples of location-based services include a tourist-information system in Italy and a traffic-information service in South Korea. According to Jean-Michel Durocher of Webraska, a location-based services firm in Paris, the most popular services are currently those that enable users to find the nearest restaurants, railway stations, car parks and petrol stations. Other uses for the technology include giving directions to pedestrians and car drivers, and providing localised weather forecasts, a service that seems to be particularly popular in Germany.

Inevitably, the most advanced implementations of location-based services can be found in Japan. In Tokyo, J-Phone's J-Navi service lets users enter a phone number, address or landmark, and then searches the area within a 500-metre radius. This makes it possible to find the subway station nearest to a particular shop, or a particular kind of restaurant within walking distance of a particular office building. Most important, users of the service can download a full-colour map. Standing on a street corner in Tokyo, Yoshitaka Noda of NS Solutions, the firm that put the J-Navi system together, calls up a detailed map of the area and points out the route to the nearest subway station. A few more clicks reveal that there are 20 sushi bars within 500m of *The Economist*'s Tokyo office.

At the time of its launch in May 2000, J-Navi was expected to handle around 100,000 hits per day, but on its third day of operation it already had 1.6m. J-Navi is now used about 2m times a day. Searching is free, but users pay for the data-transport costs, so in practice it costs about ¥5 (4 cents) a time. Downloading a map costs ¥20, because it requires the transmission of a colour graphic; about 50,000 users a day request a map.

Location-based services in Tokyo, a city with few street names, may have a unique appeal. But J-Navi's popularity seems to hold a number of lessons for would-be providers of similar services in other parts of the world. First, the search area is defined by a phone number or address, so there is no need for fancy positioning technology. Second, 30% of queries involve a location other than the user's current one; it seems that people use the service to find out in advance how to get somewhere another time. Third, although J-Navi was expected to be used mainly by business users and commuters, it has turned out to appeal to a far wider audience. Fourth, using J-Navi costs about the same as sending a text message; the service is popular because it is cheap. J-Phone gets very little revenue from the service itself, but uses it to generate traffic and to distinguish itself from its competitors.

Looking up addresses and nearby restaurants does not seem to be a particularly lucrative opportunity: a typical user is unlikely to use the service more than a couple of times a week. But there is another potential use of location-based services that could generate more traffic, and hence more revenue: mobile advertising.

A message from our sponsor

The appeal of mobile phones to advertisers is obvious: they are personal devices, they spend all day with their owners, and their whereabouts are known. Proponents of location-based marketing see all sorts of mouth-watering opportunities. Someone walking down the street might be alerted by his phone to special offers from nearby shops; or everyone attending a pop concert might have a coupon offering a discount on CDs sent to their phones. Frost & Sullivan, a consultancy, predicts that by 2005 some 37 billion advertisements and alerts will be sent to mobile devices in Europe, and that 65% of users will be prepared to receive ads in this way. Such messages are expected to be worth $7.4 billion in revenues.

It sounds like a great idea for advertisers and operators, but more like a nightmare for consumers, many of whom are already fending off a growing torrent of junk e-mails on their PCs. Research by Gartner says a surge of “spam” text-message advertising is probably inevitable in the coming months and years. To avoid offending people, mobile advertisements must be optional (ie, users must actively request them), personalised, moderate in volume (no more than five a day), and free to the recipient. One thing that might persuade people to accept mobile advertising could be the use of advertising to subsidise access costs.

One trial, carried out in Britain by the Mobile Channel, a mobile advertising company, seemed to suggest that mobile advertising has a bright future. It found that text-message advertisements had an average response rate of 10-20%, far higher than the response rate to direct mail (3%) and Internet banners (less than 1%). But novelty has a lot to do with it: early experiments with Internet advertising suggested that it, too, would be wildly successful. It would be very dangerous to read too much into these early results.

That said, it is telling that Vesku Paananen, a Finnish wireless entrepreneur who pioneered ringtone downloads in 1998, has now set up a new firm, Add2Phone, for mobile marketing. The company sent over 2m advertising messages in the first six months of this year. In Finland, Mr Paananen notes, firms are forbidden from sending unsolicited text messages, so users must opt in. Users must also, he cautions, have a means to unsubscribe, or be sure that they will receive messages only for a limited time (a week, say, or a month) when they sign up for a promotion. ZagMe, a British location-based advertising service, allows people who enter a shopping mall to specify how long they plan to stay, and sends them coupons and advertisements during that period, but not thereafter. In Japan, J-Phone's location-based advertising service, J-SkyStation, has a clever technological fix for the problem of obtrusive messaging: advertisements are sent silently into a special cache on users' phones, allowing users to look if they choose, or else ignore them.

Yet all in all, it is clear that location-based services in general, and mobile advertising in particular, are not going to be huge moneyspinners. Analysys puts the total value of the location-based services market at $18 billion by 2006; Ovum, another consultancy, suggests $20 billion. That may sound a lot, but it is modest compared with the text-messaging business, which already brings in over $30 billion a year worldwide and is still growing fast.

Communication, not commerce

So what is the killer app? Mobile operators will probably make some money on m-commerce and location-based services, if only through the associated transport revenues. Access to free content, such as online banking and train timetables, will also enhance transport revenues. And the example of i-mode suggests that users may be prepared to pay a small amount to receive news, weather, sports scores, horoscopes and so on. But the subscription revenue associated with these services is tiny; again, the real money is in the transport. What can operators do to boost traffic and maximise transport revenues?

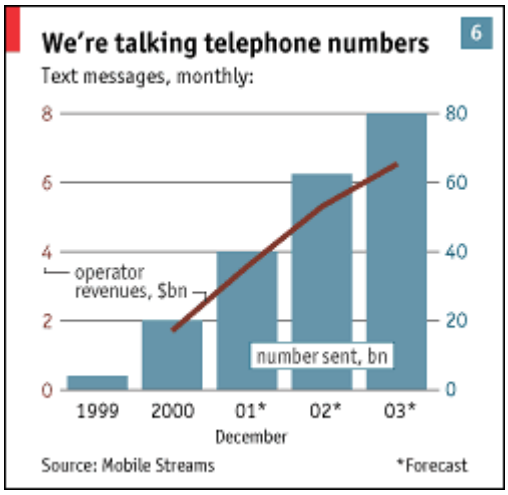
The answer seems obvious: person-to-person communication. The success of text messaging relative to WAP shows that people like to use their phones to communicate with each other, rather than to download information from content providers. In the words of Andrew Odlyzko, a former AT&T researcher who is now at the University of Minnesota, “Content is not king—connectivity is more important.” Indeed, he argues that the killer app for 3G phones might turn out to be increased voice traffic.

There is some evidence for this; for example, i-mode users make more voice calls than do voice-only subscribers. They may be ringing in response to incoming text messages and e-mails, or they may be taking advantage of the fact that phone numbers can be embedded as clickable hyperlinks in i-mode

pages; look up a restaurant review on an i-mode phone, and you can call the restaurant with a single click. Yutaka Mizukoshi of the Boston Consulting Group in Tokyo explains that even if he has a desktop phone in front of him, if an e-mail arrives on his i-mode phone asking him to call, he will simply click and call back using his i-mode phone. The effect of combining voice and data, he says, is to concentrate communications into the mobile handset.

The key to increasing traffic, therefore, and hence revenue, is to offer new kinds of person-to-person communications services. E-mail is one obvious example, and one that accounts for a large volume of i-mode traffic; another is group-based text messaging, which allows individuals to communicate with a group of people via a single message. Kare Souru of Popsystems, a Finnish group-messaging firm, suggests that operators can make group messaging attractive by making it 15-20% cheaper to send a message to a group than to each of its members individually. The revenue per message is thus smaller, but the volume will be much higher. Popsystems' trials with a schoolgirls' basketball team found that group messaging increased message traffic per user by 60%, and overall revenue (including voice) by 20-30%. Furthermore, Popsystems found that when users are able to establish their own groups and invite others to join, each user recruits an average of 2.5 additional users per month.

Another step beyond simple text-based messaging is to add graphics and animations. There are already several competing standards to do this, notes Mr Buckingham of Mobile Streams. But a standard called EMS, for enhanced messaging service, is pulling ahead of the pack, at least in Europe. It uses multiple text messages to send text, plus a larger payload of graphics or music. These messages are then combined on the recipient's phone; if the phone is not capable of supporting graphics or music, only the text is displayed. This multiplies message traffic. It also introduces users to the idea that more complex messages cost more to send, which is crucial if users are to be charged extra for more complex services in future.



EMS, however, is just a transitional format. The greatest scope is for multimedia messaging (MMS), which is like text messaging, but allows pictures and sound clips to be sent as well as text. Unlike EMS, MMS is a true industry standard, and has far wider support. The potential for MMS is enormous. Europeans are already using text messages in place of holiday postcards: imagine being able to send pictures too. In Japan, J-Phone's handsets with built-in cameras have been a huge success. And since MMS is based on Internet e-mail standards, it will be possible to send MMS messages between phones and PCs, which is currently hard to do. This will increase traffic further. Also, since MMS messages will use more bandwidth than text messages, operators will be able to charge more for them. MMS is also likely to boost voice traffic: according to research carried out by Nokia, seven out of ten picture messages generate a phone call in response.

As 2.5G and 3G networks come into wider use, EMS and MMS are likely to figure prominently in persuading users to upgrade to colour-screen handsets. Low- resolution CMOS sensors, of the kind found in cheap digital cameras, are a commodity, and can be added to handsets very cheaply. Location-based services and mobile advertising will also be able to exploit picture-messaging services, by transmitting maps or colour photographs. Pornography is one inevitable application; already, several wireless porn outfits are lining up to offer their services.

Once users have switched to fancier handsets, the hope is that text messaging and associated services will become precursors to more advanced services. Having got used to paying for information delivered to their phones by buying, say, ringing tones, goes the theory, users may be prepared to try other things. Rick Allen of Logica, a leading vendor of messaging and billing systems, calls this the “three box” strategy. The idea is to lead users from text messaging on to content, then to location-based services, and eventually on to m-commerce.

Say something

It should come as no surprise if the killer app for the mobile Internet, at least for consumers, turns out to be person-to-person communication. That, after all, has been the golden prize of all previous technologies, from telegraph to telephone to mobile phone. The Internet's killer app is e-mail, even if the web accounts for more traffic. Transmitting speech, words, pictures and graphics are all social activities,

and mobile phones are primarily social devices. “Messaging is a much bigger chunk of this new market than people want to talk about,” says Niklas Savander of Nokia, the world's leading handset maker. “Perhaps they think it's boring.” Certainly it means that in the short term, the fancier possibilities of the mobile Internet are more likely to be adopted by businesses.

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A different way of working

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From The Economist print edition

All sorts of companies are finding mobile Internet technology surprisingly useful

FOR all the hullabaloo over new business models and dotcom startups, the benefits of the fixed-line Internet have accrued mostly to existing firms that reinvented themselves around it, rather than new firms that started from scratch. By adopting e-mail, intranets, extranets, customer-relationship management (CRM) and enterprise-resource planning (ERP) systems, large firms have made huge investments in Internet technology. It is now a relatively simple step, say proponents of the mobile Internet, to extend all of these systems to mobile devices, so that employees can access the information they need from anywhere.

Mobile devices, says Martin Dunsby of Deloitte Consulting, enable workers on the front line to get at data in the back office. “The value is not from cutting the cable,” he says, “it's from the process change that's enabled by the technology.” He gives the example of time-and-expense tracking, in which consultants enter the amount of time spent working on a particular project into a handheld device. This may not be any quicker for them than filling in a paper timesheet, but it means that the data can be sent back to head office straight away and an invoice issued, rather than the information being keyed into the accounting system at head office several days later. Similarly, when visiting a client, a salesman can use a wireless handheld device to call up the latest inventory levels, technical support histories and so on.

It may sound mundane, but given the sorts of corporate information systems that many firms, particularly in America, have already implemented, it is a logical next step. This means, says Mr Dunsby, that in the next three years most of the action on the mobile Internet will be in the corporate market. Adoption will be fastest in America: a survey by Zona Research found that 66% of American firms are planning to deploy mobile Internet technology within the next three years, if they have not done so already.

Business use of the mobile Internet also escapes the chicken-and-egg problem of aligning services with available hardware: a firm that wants to provide its workforce with wireless access can specify the entire system from top to bottom, from handsets to software to network provider. Existing technology, in the form of 2.5G and Wi-Fi networks, is already good enough to make this possible today: there is no need to wait for 3G. And there is a growing range of handheld computers, Internet-capable phones and intermediate devices to choose from.

The wireless workforce

At present, adoption of mobile Internet technology makes more sense in some industries than others. Not surprisingly, it holds particular appeal for firms with mobile workforces. The early adopters, says Joan Herbig of XcelleNet, a firm that provides remote management software for corporate handheld

devices, are the same users that first adopted laptops in the 1990s: sales forces in financial services, health care and pharmaceuticals, field workers for utilities and so on.

Surely most mobile workers already have laptops? Yes, but wireless handheld devices have a number of advantages. Laptops have complicated operating system software, plus a whole lot of additional software loaded on top, whereas handheld computers or phones are much simpler machines, with almost nothing to go wrong. This means that support costs are lower by a factor of at least five. When Goldman Sachs employees were given BlackBerry e-mail pagers developed by Research in Motion, a Canadian wireless firm, their use of laptops fell by 45%. A fifth of BlackBerry users stopped using their laptops altogether.

The BlackBerry looks like a glorified pager. It has a small keyboard and an always-on wireless data connection, and allows users to send and receive e-mail on the move as though they were sitting in front of their desktop PCs. It is the first of a new breed of devices taking up the space between handheld computers and mobile phones. Its proponents claim that it makes employees more responsive, because they can reply to messages at any time. It can also make them more productive, because they can catch up with their e-mail on the move rather than back at the office; a BlackBerry, unlike a laptop, can be used in a taxi. According to figures from Boston Consulting, the BlackBerry costs $900 per user per year. For an employee earning $100,000 a year, the system pays for itself even if it saves only five minutes a day.

In addition to savings in support costs and improvements in productivity, handhelds have other advantages over laptops, says Richard Owen of AvantGo, a firm whose software links handhelds to corporate information systems. Handhelds are less obtrusive (salespeople, he says, hate having to boot up laptops in front of customers), and “you look like you're on top of things”. Using a laptop simply to fill in on-screen forms and gather data is overkill, so salespeople are often reluctant to use laptops to collect data in the field, says Mr Owen. One of AvantGo's clients, Alcatel, a telecoms-equipment maker, reported a fivefold increase in the amount of data sent back from the field by sales representatives after introducing handhelds.

But mobile Internet technology may also hold attractions for firms without large roving workforces. Research carried out on behalf of BT Cellnet, a British mobile operator, found that employees spend an average of two hours a day away from their desks, and return to a backlog of e-mail that takes 45 minutes to deal with. “Once upon a time, people sat in an office from nine to five, and that was the boundary of their world,” says Chris Matthiasson of BT Cellnet. “Now everyone in an organisation is a mobile worker.” He cites trends such as the growth of flexible and off-site working, teleworking, longer commuting times, and the fact that large companies tend to be geographically spread, which requires employees to travel more than they used to. Mobile devices, he suggests, allow the best use to be made of travelling time, and of time between meetings. Wireless technology, he implies, can offer an immediate productivity gain, no matter what business you are in.

Going wireless need not be a huge investment. Most firms already have e-mail systems in place, and numerous wireless-technology firms have popped up to help firms extend these to wireless devices with the minimum of fuss. The BlackBerry system, for example, can be set up in a few hours; it simply involves installing an extra box that establishes a secure link between the wireless operator's systems and the client company's e-mail server. The wireless services of Seven, a Silicon Valley wireless startup, do not require firms to install any new hardware at all. Instead, Seven's software resides in the network operator's systems; it queries the client firm's systems across the Internet, then reformats the resulting data to make them suitable for display on a phone.

Suck it and see

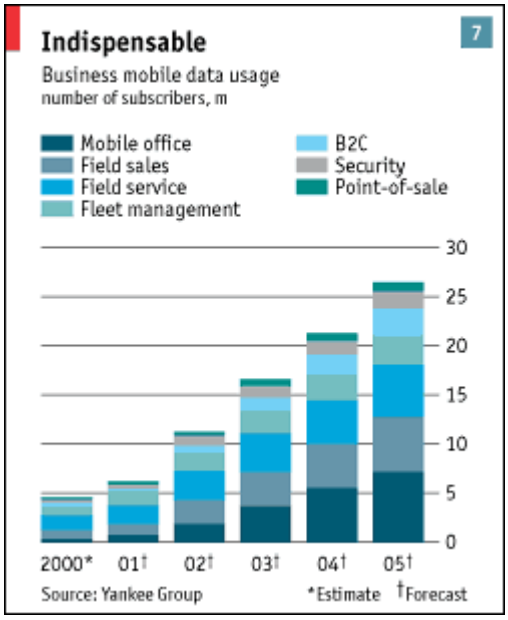
Firms that wish to go wireless, therefore, need not buy fancy new equipment, but can simply pay a network operator to provide wireless access as a subscription service. Seven's corporate e-mail system, for example, is typically resold by network operators for £3 ($4.40) per user per month; other applications cost extra. There are, of course, transport charges on top, and employees must have suitable handsets. But since wireless access is a service, not a product, it is relatively easy for firms to try it out. Tim Dunne of Nextel, a business-oriented American wireless operator, says most firms start off by using Nextel's 2.5G network to access e-mail using WAP phones, and then move on to wireless-enabling their other e-business applications. Nextel recently introduced a Motorola handset capable of running small pieces, or “applets”, of software written in Java. This makes far more complex applications possible, because it allows firms to write their own software to run on the handset if they choose.

Foot in the door

So the technology is available, but the wireless industry still has work to do in convincing firms to adopt it. “Wireless people get obsessed with networks, carriers and so on, which is like airlines thinking about planes, not passengers,” says Mr Owen. “The industry has been very poor at explaining why any of this is worth doing, rather than just being interesting technology.” The BlackBerry has succeeded, says Mr Owen, because it is easy to explain what it does, and why it is useful. To get a foot in the door, he jokes, the mobile Internet needs a clever-sounding theory to justify it, such as “total cost of ownership” (which encouraged firms to centralise their computing systems) or “just-in-time ordering” (which encouraged them to adopt fancy inventory-management systems).

At the same time, there is the danger of overhyping the technology, as happened with WAP. “People have to understand that wireless applications are not web applications. It's completely different,” says Bill Nguyen of Seven. Call up your e-mail on a PC, he explains, and you can list dozens of messages at once, sort them and manipulate them in various ways. Not so on a handset. This means, says Denise Lahey of OracleMobile, that the software that pipes information to the handset needs to be smarter: to figure out which e-mails are important, perhaps given the time of day, the user's calendar, and even the user's location. On the way to a meeting that is suddenly cancelled, for example, a user will probably want to e-mail the other people who were due to attend; so when a new mail is created, their names can appear at the top of the address-book list.

Although the mobile Internet is currently being sold as a means of improving productivity and reducing support costs, the widespread deployment of wireless technology is likely to have far more wide-ranging effects. According to Joe Manget of Boston Consulting, the use of wireless will go through three distinct stages. The first, which is currently under way, involves extending existing systems and processes to mobile devices to achieve productivity gains. For example, Nissan, a Japanese car maker, found that giving its salesmen wireless access to up-to-the-minute inventory and pricing information reduced the average number of visits required to close a sale from five to three and allowed a 40% cut in back-office staff. McKesson HBOC, America's largest drug wholesaler, has introduced wireless devices to track inventory and shipments. The company spent $52m on 1,300 handheld computers and on equipping its distribution centres with wireless-network coverage. Warehouse workers use the technology to monitor inventory, and to record and check the contents of each shipment, thus eliminating the need to count inventory by hand and reducing errors. McKesson has already saved more than the cost of installation, having achieved an 8% productivity gain and an 80% fall in the number of incorrect shipments.



The next stage, says Mr Manget, will involve the transformation of existing business models using wireless technology. At Svenska Cellulosa Aktiebolaget, a Swedish pulp and paper company, foremen use a wireless system to send instructions to loggers in the field, specifying which trees to cut and in what order. This enables the company to co-ordinate harvesting decisions with inventory and transport requirements and match those decisions to market needs. But the transformation of business processes is not without risks; the mobile Internet, like the fixed-line Internet before it, is likely to disrupt existing power structures and decision-making processes within organisations, as frontline workers gain access to corporate information they never had before. In the final stage, entirely new business models will emerge that would not have been possible without wireless.

One development Mr Manget notes with particular interest is the rise of machine-to-machine, or “M2M”, communications. In Japan, for example, NTT DoCoMo has got together with vending-machine manufacturers and soft-drink companies to equip vending machines with wireless capability. The new machines not only accept payments from wireless devices but also use wireless technology to transmit information on inventory levels and maintenance problems. Drinks companies use the data captured to improve distribution and product selection, and to reduce the number of out-of-stock items, which has increased profits per machine by as much as 70%.

Let machine talk to machine

Similarly, Toshiba is using wireless technology for remote monitoring of photocopiers, so that technicians can be dispatched as soon as there are signs of a problem. This reduces servicing costs and, since machines are out of action less often, increases usage and revenues. Caterpillar, a construction-machinery maker, is also using wireless technology to ensure that its machines are kept running smoothly; this has reduced downtime by 66%, and has resulted in a 60% reduction in maintenance costs, since worn parts can be replaced before they fail and cause damage to other components. In the long term, this approach may well be extended to all kinds of machines, including cars and household appliances; on the mobile Internet, machines might eventually outnumber people.

Such futuristic visions aside, the mobile Internet clearly has much to offer companies here and now. Corporate enthusiasm for the technology may even kick-start interest in new services in the consumer market, says Mr Nguyen; after all, employees are consumers too. Give an employee a PC, and he is connected to the Internet when he is at his desk; but give him a mobile device, and he is connected anywhere, any time. One of the mobile Internet's knock-on effects could be that the distinction between work and leisure will become increasingly blurred.

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Wireless bunfight

Oct 11th 2001
From The Economist print edition

Who would have thought that thin air could be so competitive?

IN THE lobby of Nokia's glistening glass-and-steel headquarters just outside Helsinki sits a table with a huge silver-and-bronze chessboard inlaid into its surface. It might have been purpose-made to symbolise the complicated manoeuvring currently going on in the industry.

Mobile operators, who act as the hub between customers, handset makers and content providers, have the hardest task. Most of them are saddled with huge debts after paying billions for their 3G licences; the agreements currently being struck to share network infrastructure are bound to lead to broader consolidation.

To make matters worse, they will find that providing complex data services is a very different business from running a voice network. Operators are having to choose partners to provide content, and decide which services to offer their customers. To attract business customers with new services such as phone-based e-mail, operators are having to get far more involved with their corporate customers' computer systems. In short, they either have to get into the business of system integration or to form partnerships with systems integrators and software firms. Unless they move into these new areas, operators risk being turned into “dumb pipes” by specialist wireless firms acting as resellers of airtime.

Operators also face potential conflicts with banks. Given their ability to charge users for small transactions, they are clearly in a position to set up their own electronic payment systems. Some customers trust their operator no less than they trust their bank. In Europe, a number of operators have applied for banking licences. Mobile phones might emerge as a popular method of payment, at least for small items. But individual operators will not be able to install equipment at the point of sale in shops, restaurants and so on; the banks and credit-card companies are much better placed to do that. Such equipment will need to communicate with phone handsets, so handset makers will also need to co-operate.

The handset makers, for their part, have an ambivalent relationship with operators. Both need to ensure that their equipment is mutually compatible. This can make for rather cosy relations between particular operators and handset makers. In Japan, for example, Panasonic and NEC are chummy with DoCoMo; Kyocera and Toshiba are close to KDDI.

In other parts of the world, where plug-in chips, called SIM cards, make it easier to switch from one operator to another on the same phone, things are not so friendly. Both the operators and the handset makers would like to “own” the customer. This tension is particularly evident in the case of Nokia, the world's largest handset maker. Because Nokia makes some of the sleekest, sexiest phones around, operators must include Nokia models among the choice of handsets they offer their customers. Nokia, for its part, wants customers to think of themselves as Nokia users. By adding unique features to its phones,

it can help ensure that customers buy another Nokia model next time.

The handset makers, meanwhile, are fighting new battles of their own. At the moment, thanks to different technology standards in different parts of the world, the handset market is balkanised. But 3G phones will be a global standard (or as close to it as makes little difference). The Japanese phone makers see this as their opportunity to break into new markets, notably in Europe, where they are currently thin on the ground. Handset makers elsewhere see 3G as a chance to get into the traditionally closed Japanese market. In preparation for this global bunfight, manufacturers are already consolidating. Ericsson, a Swedish telecoms firm, has set up a joint venture to make handsets with Japan's Sony. Similarly, Toshiba, another Japanese company, has an alliance with Siemens, a German electronics firm.

Snazziness is not everything

Who will win? According to one school of thought, the Japanese have an insuperable lead, thanks to i-mode and to being the first to launch a commercial 3G service. They know how to make small, light handsets with colour screens and Internet features, and Japanese manufacturers already dominate other areas of consumer electronics, such as hi-fi equipment, video recorders, DVD players and televisions. But although they are good at making snazzy phones, Japanese manufacturers have little experience of working with operators abroad.

Nokia and Ericsson initially rose to prominence thanks to the decision by Scandinavian countries to establish a common mobile-phone standard in the 1980s. This gave Nokia an incentive to make phones that work reliably in different countries and on different networks, and are easy to use. The company is also strong in design and marketing and has a powerful brand. According to Mark Davies Jones, an analyst at Schroder Salomon Smith Barney, the biggest threat to Nokia's dominance could be from Samsung, a Korean electronics firm. Already dominant in South Korea and America, Samsung has a proven track record in building phones that work on the CDMA technology which underpins all the 3G standards, and its phones are considered as easy to use as Nokia's.

Elsewhere on the battleground, the content aggregators—or portals—are also fighting over customers. Some portals are owned by operators, such as Genie (owned by BT), zed (owned by Sonera) and T-Motion (owned by Deutsche Telekom); others, such as Yahoo!, are independent. Portals matter because they aggregate content, and access to content generates transport fees for operators. At the moment portals are quietly gathering subscribers, with a view to becoming mobile virtual network operators (MVNOs) at some point in the future. The idea is that network operators will act as wholesalers of network airtime to MVNOs, which will be better at catering to particular niches. As wholesalers, network operators will have to share transport revenues with their MVNO partners, but MVNOs should boost the overall amount of traffic. So operators will contemplate offering their networks to MVNOs only once their own revenues have levelled off and they want to reach out to new customers, says Scott Goodwin of Speedy Tomato, a Europe-wide portal.

All kinds of firms might choose to become MVNOs, but the two obvious examples are banks and media companies. If handsets were to become a significant new payment mechanism, banks might decide to team up with operators. Media firms, for their part, have lots of content to offer, and will no doubt want to get their hands on the transport revenues that go with it. That makes record companies, cinema chains and media conglomerates, notably Disney and AOL Time Warner, likely candidates for becoming MVNOs.

Who will emerge victorious from this free-for-all is still far from clear. As mobile phones are used for more and more everyday activities—and even become a “remote control for life”, as some in the industry believe—it may come down to whom people are most inclined to trust.

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A mobile future

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From The Economist print edition

There's much more to it than the Internet without wires

TO GET some idea of how difficult it is to predict the future of the mobile Internet, talk to Marty Cooper, a veteran of the wireless industry. On April 3rd 1973, Mr Cooper stood on a street corner in Manhattan with an odd-looking white plastic brick-shaped object in his hand. It was a device called a Dyna-Tac, developed by Motorola, an American electronics firm. To curious glances from passers-by, Mr Cooper pressed a few buttons, held the brick to his ear and started talking. He was making the first-ever cellular phone call. In acknowledgment of his role in pioneering this new technology, he is now known as “the father of the cellular phone”.

But that epoch-making call did not cause mobile phones to fly off the shelves. To drum up interest in these exotic new devices, says Mr Cooper, phone companies had to resort to a hard sell. “We had to tell the first users: you can use this to fill the time in your car,” he says. “It was almost fraudulent, because the real value is the freedom you get—you no longer have to be in the office or the car, you can be reached anywhere. It's the removal of the chain between you and your desk. And that's the lesson it took some years to learn.”

When you call a fixed telephone, you call a place; when you call a mobile phone, you call a person. Mobile phones enable people to stay in touch wherever and whenever they want. With over 800m mobile phones in use worldwide, this may seem obvious now, but in 1973 it was impossible to imagine. Even in the early 1980s, McKinsey, a consultancy, predicted that 900,000 Americans would have mobile phones by 2000; the actual figure was over 70m.

The Internet also seemed to arrive when no one was looking. Back in 1993, just before the Internet boom, who would have foreseen the rise of Napster, or eBay, or Amazon? So making forecasts about the development of the mobile Internet, the offspring of two such spectacularly unpredictable technologies, is clearly dangerous. Peering into the fog, however, this survey ventures to predict that in the short term the mobile Internet will be used by consumers mainly for interpersonal messaging, and by businesses mainly to extend corporate information systems to mobile devices. Beyond that, who knows?

From horseless to wireless

For a historical analogy, look back to the advent of the horseless carriage, or automobile, at the end of the 19th century. At first, the most notable feature of the horseless carriage seemed to be its horselessness. But few people today climb into their car and exclaim at the absence of a horse to pull it. The mobile Internet is still at that first, horseless stage: people tend to think of it simply as the Internet without the wires, rather than something entirely new.

Yet the mobile Internet is something new, because of wireless technologies' capacity to bathe the world in bandwidth and liberate people and devices from the constraints of fixed locations. Just as water, gas and electricity are ubiquitous, always-on utilities in most of the developed world, wireless technology promises to do the same for information, by making the Internet as pervasive as the air we breathe. A British mobile operator, BT Cellnet, spotted the parallel and is renaming itself O2, the chemical symbol for oxygen.

The longer-term effect of existing technology is hard enough to imagine as it is, but there are even stranger things in the pipeline. One trend to look out for is ad-hoc networking, in which the network architecture is much more fluid than in today's systems. Handsets might, for example, double as portable base-stations, routing data to and from other nearby handsets. So far the best working example of this idea is Cybiko, a Russian-made electronic toy that allows users to exchange messages and play games with other users nearby. Teenagers lap it up. Jens Zander, of the Royal Institute of Technology in Sweden, imagines a mobile network where each user is given a six-pack of small base-stations when he buys a handset, and is asked to sprinkle them around randomly; the network has no centre, and grows virally. This sort of idea is reminiscent of the “peer-to-peer” approach used by Napster, the infamous music-swapping service. It also resonates strongly with those building guerrilla Wi-Fi networks.

Meanwhile, Mr Cooper's new firm, ArrayComm, based in San Jose, California, is pushing a high-speed wireless data system called iBurst, which relies on “smart antennas” to make more efficient use of radio spectrum than 3G networks. Time Domain, based in Huntsville, Alabama, has developed a system called “ultra-wideband” transmission that uses low-power radio pulses to transmit data at high speeds over short distances. Even now, more than a century after Guglielmo Marconi pioneered the transmission of wireless data, there is clearly vast scope for further innovation.

Little wonder, then, that so many companies, big and small, are trying to shape the development of the emerging mobile-Internet market. Given the current economic climate, life is turning out much harder for wireless firms than it was for the dotcom generation, but the builders of the mobile Internet have the advantage of hindsight. “People are trying to learn from the experience of the fixed Internet,” says John Sims of 724 Solutions, a wireless software provider. “They're saying, ‘let's not repeat those mistakes'.”

Lessons learnt?

For example, says Mr Sims, there is far more awareness of the need for security and privacy on the mobile Internet than there was in the early days of e-commerce. And operators, he notes, are well aware of the danger of being turned into “dumb pipes”, as happened to the fixed-line Internet-access providers.

Another difference, says John Little of Portal Software, a firm that provides billing systems to mobile operators, is that wireless firms expect to have to experiment in order to find business models that work. Internet start-ups, in contrast, often committed themselves to a clever new business model, and were scuppered if it failed to work. “They did not build in ways to change their minds,” Mr Little observes.

The demise of the dotcoms has also taught mobile-Internet firms to be deeply suspicious of business models that rely on advertising revenue. The good thing about mobile phones is that they provide a means of charging money for content and services, so tangible revenues are available now, not in the distant future.

The mobile Internet is also notable for the absence of a dominant company in the industry; the nearest equivalent is Nokia, but that is no Microsoft. At every level, from network infrastructure to software to operators to handsets, the industry is still hugely fragmented. No doubt there will be much consolidation in the coming years. But so far, says Richard Owen of AvantGo, “In wireless, Microsoft's non-monopoly has created a lot of innovation, because there isn't a dominant player.”

But the mobile Internet does not get top marks for everything. Two obvious weaknesses are that it still puts too much emphasis on technology for its own sake, rather than on the benefits to users; and that, until recently, it has failed to recognise the importance of person-to-person interaction, putting its money on access to centralised content instead. It should have been quicker to pick up clues from the way in which earlier communications technologies were used, and particularly from the success of text messaging.

Ringing a bell

Caution be damned: here is a final prediction. The Internet's mobile offshoot will turn out to be an entirely new medium, as different from the Internet as the telephone was from the telegraph. It will be accessible to people beyond the reach of today's Internet, notably those in the developing world, because it will not require complex and costly PCs, and will thus bring many of the benefits of the Internet to a far wider population than is able to enjoy them at the moment.

Funny how history repeats itself. The mass-market successor to the telegraph proved to be the telephone. The successor to that modern-day telegraph, the Internet, may well be the telephone again.

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Managing in a downturn

Snip, snip, oops!

Oct 11th 2001 | LONDON, NEW YORK AND SAN FRANCISCO
From The Economist print edition

Companies are desperately seeking ways to cut costs, which mostly means cutting jobs. But this is no panacea

RUNNING a company in boom times is relatively easy. A downturn is less forgiving: mistakes show up at once. Now, many executives are living through a deterioration in the business climate more abrupt than they have ever experienced, and having to take decisions they have never faced before. Today's judgments will determine whether their company survives the difficult year ahead.

Most of those decisions centre on cutting costs. Companies have switched abruptly from managing for profit to a frantic search for ways to conserve cash. The effect of uncertainty, says Rick Wagoner, chief executive of General Motors, is that “we have to focus on running the business day-to-day, putting a lot more attention on short-term issues.” The long term is impossibly uncertain; the short term is where money will be made or lost.

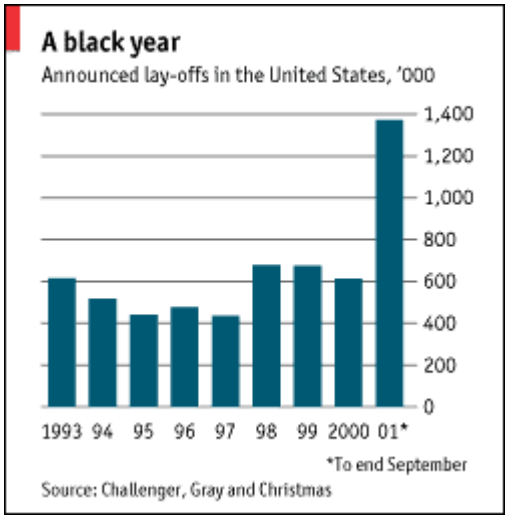
So British Airways is combing through its operations to look for ways to keep cash, says David Spurlock, its strategy director. One obvious way is to adjust capital spending on new aircraft. BA is also trying to manage overtime working more efficiently, as an alternative to making even bigger redundancies. Where sacking people involves paying large severance packages, restricting overtime may be a more cash-friendly option.

Another way to save cash is to scrap purchases of non-essential services. During the 1990s, companies farmed out all sorts of peripheral activities. Daniel Pink, an American writer, described this human outsourcing as a move towards a “free-agent nation”. Now, many free agents are early casualties of cost-cutting. A partner in a small public-relations business in London complains: “The terrorist attacks came just as our big customers were setting their budgets for the coming financial year. We've started to get letters giving us three months' notice to end our contracts.”

Many companies find it cheaper (and easier) to shed temporary workers first, especially in continental Europe, with its draconian employment laws. When Alcatel, a French engineering giant, recently shed 1,045 jobs in France, 873 of them were temporary.

On both sides of the Atlantic, lay-offs are rising fast. Technology and manufacturing have been depressed for the past year. Since the attacks, the gloom has spread through service industries. In the United States, more than twice as many lay-offs have been announced already this year as in the whole of 1999 and 2000

combined (see chart). Some 200,000 jobs vanished from payrolls in September alone.



Many firms saw September 11th as an excuse to bring forward cuts that they were already considering. First Call, an American research company, reckons that almost two-thirds of recent profits warnings have blamed the terrorist attacks for their problems: implausible, but convenient for embattled managers.

John Challenger, chief executive of Challenger, Gray and Christmas, an outplacement firm in Chicago, has been in the business since the mid-1960s. He cannot remember such a sharp and widespread deterioration in the job market. The airline staff cuts alone have left him gobsmacked: “I don't remember seeing anything so big in one industry,” he says.

Last year's homilies about the importance of keeping talent are forgotten. “Divisional managers tell me it's like standing in front of an oncoming train,” says David Hofrichter, a partner at PwC/Unifi Network, a consultancy. “When the CFO says we need to fire a third of our staff to make our numbers, they don't want to raise their hand and argue that the call-centre people or brand managers should stay.” Those talent-spotting trips to business schools are being axed too. “In 30 years I have never seen so many companies rescinding offers,” says Karin Ash, director of career services at Cornell University. “The average is usually a couple of students. This year, we have had 100 already.”

However, a few companies are staunchly resisting cuts. Southwest Airlines is one. Fred Reichheld, the author of two books on loyalty, is full of admiration: “They have a deep appreciation of how employee loyalty drives down your costs,” he says. They also have the advantage of having long taken a conservative approach to both cash and debt.

Until recently, losing your job was no great hardship. In Silicon Valley, finding new work 18 months ago often meant turning your car into a neighbouring parking lot. Even this year, the median time taken to find a new job in America declined from 2.27 months in the first quarter to 2.07 in the second. In the third it rose, but only to 3.04 months. Health care, energy, security and defence have all been hiring.

As a result, some who lost their jobs before the summer have been slow to look for new ones. “I took the summer off,” says one woman, laid off last May. “So did lots of investment bankers. You couldn't get a coffee on the Upper East Side this summer for men in Cole Haan loafers and khaki shorts.” Now job-hunting means being less choosy, perhaps even trying to return to that solid, dull company that the would-be high-flyer left two years ago.

Serving company and country

With America experiencing a net loss of jobs, managers are having to walk a tightrope. The events of September 11th have made their task a lot tougher, says Jeanie Duck, author of “The Change Monster”, a book on managing staff in times of upheaval. Ordinary employees, she says, have begun to ask: “Why does what we do matter? If I'm doing my job well, am I doing what my country needs?” They need leadership that responds to such emotion.

As an example of such leadership, she recalls what happened at a meeting of the North American salesforce of Pfizer, a big drug company, in Orlando, Florida, on September 11th. To continue the meeting seemed disrespectful to the dead. But with all air traffic stopped, nobody could leave. Then Mick Mosebrook, executive vice-president of sales, stood up and said: “Terrorists are intent on taking lives. Pfizer is about prolonging life. Terrorists want to disrupt daily life. We want every day to be productive. We will not allow the terrorists to have their way with us today.” And the meeting resumed.

Such responses may be hard to align with the need for hefty job cuts, however. In addition, many middle managers now expected to wield the axe have never before had to sack good workers. No wonder many of them are doing it badly, and finding their insensitivity recorded on bitter websites such as fuckedcompany.com. “Don't announce the names of the people who have to go over the public-address system,” counsels Ms Duck. “Don't say, ‘This hurts me as much as it hurts you'.”

Difficult, too, is the task of ensuring that a company loses the “right” people. Offering voluntary redundancy may seem an easy option, but it often means paying money to lose the best talent. In Germany, companies' freedom to sack is constrained by complex agreements with trade unions which generally force them to fire first those who joined last, however good they are. In America, executives fear lawsuits if they appear to be sacking too many people of one sex or ethnic group.

Even if done well, a bout of lay-offs can leave a company traumatised and unfocused. Remaining staff feel a sense of that malady of the age, “survivor guilt”. They also grow distracted and less productive, says Darrell Rigby, a senior partner at Bain, a consultancy. “They are more risk-averse and less innovative. They spend more time gossiping and looking for new jobs.” And managers' health suffers. A study in 1998 conducted at 45 American hospitals found that executives ran twice as much risk of a heart attack in the week after firing someone. No wonder nobody likes managing in a downturn.

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Scenario planning

The next big surprise

Oct 11th 2001
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Wanted: a new way of planning for the future

PETER SCHWARTZ is the man who has done most to popularise the notion of scenario planning over the past ten years. His book, “The Art of the Long View”, brought an arcane technique for thinking about the future (largely developed by Royal Dutch/Shell in the 1970s) to a wider audience, both corporate and political. Now president of Global Business Network (GBN), an organisation dedicated to “collaborative exploration of the future”, Mr Schwartz was due to chair a conference in New York on September 12th. Its subject? “The Big Surprises”.

Because of the attacks on America the previous day, the conference and its mirror image (due to be held in London two days later) were cancelled. But they were rescheduled last week, and the attendance at both was 50% higher than was booked for the original events. Suddenly, many more people are interested in thinking about big future surprises.

Scenario planning (often known as the “Shell method”) is the most popular way of doing this. It relies on imagining the future rather than extrapolating from the past. When the Hart-Rudman Commission on “American security in the 21st century” looked into recent futurist studies in 1999, it analysed 20 in detail. Of these, it found that five followed the Shell methodology very closely, another six used a variation, and six more used “very simplified versions”. In other words, Shell's approach has had the field much to itself.

Pick your future

Shell has been pioneering the technique for 30 years, and on October 3rd, in New York, it took the wraps off the latest refinement of its own scenarios up to the year 2050. It has narrowed its vision down to two scenarios: “Dynamics as Usual” and “The Spirit of the Coming Age”. The first sees only a gradual shift from carbon fuels, through gas, to renewable energy. The second looks at the possibility that a technical revolution will create dynamics that are anything but usual.

Asked whether the attacks on New York called for any refinement of the scenarios, a company spokeswoman says: “We need a few more years before the events of September 11th can be factored in.” Few organisations are so laid-back. But terrorist threats are nothing new to the oil majors. Shell works in Congo, for instance, and BP in Colombia. Energy companies routinely include security issues in their scenario planning.

The new thing that companies need to add, says Mr Schwartz, is the Muslim element—in particular, the extent to which Islamic fundamentalism might block the spread of western capitalism and democracy. At one extreme, he suggests that companies imagine a scenario with a civil war between reformers and fundamentalists in at least ten Muslim states at once.

But this is not, strictly speaking, the next new thing; it is what scenario planners should have been daring to dream ten years ago. Scenario planning has been consistently criticised for its failure to spot in advance the weak signals that are going to emerge from the surrounding noise and change all our lives. The Hart-Rudman Commission worried that the futurist studies which it examined had “overly common threads” (and Islam was not one of them). It said they concentrated on present concerns and rarely identified “other possibilities that produce startling emergent behaviour”.

So where might the next big surprise lie? The conference on the subject threw up various suggestions, including the Colombianisation of Mexico, the positive economic effect of later retirement and the

emergence of Europe as the world's superpower. But maybe companies will just come up with a brand new way of thinking about the future. That really would be a surprise.

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Music industry

In a spin

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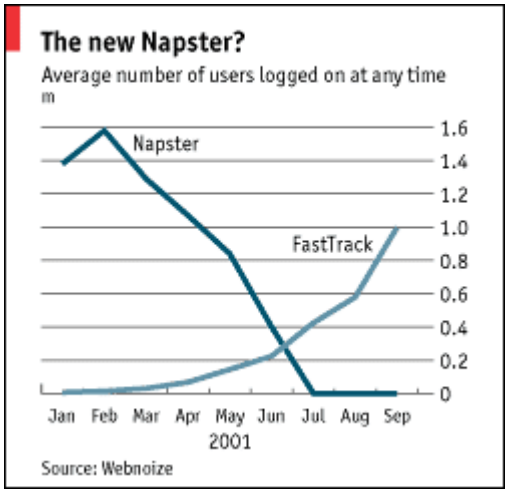
The music majors won their battle with Napster, but the online war is not over

AP

Peer-to-peer or leer-to-leer?

IN JULY, when the music industry had squished Napster's illegal file-sharing system, the big record companies seemed at last to be getting a grip on the online music market. Access to Napster had plunged from a high in February of 1.6m users at any given time, to virtually nothing. And the big five record labels had agreed to launch their own, legal, alternatives.

Yet last month, the number of users swapping files at any given moment on three new file-sharing networks—MusicCity, KaZaA and Grokster, which all use a technology developed by a Dutch company called FastTrack—had reached 1m (see chart), and the figure is growing. Last week, 1.7m users downloaded the software to connect to MusicCity alone, and from only one of the websites that offer this service. Have the record companies lost their grasp once more?



On the face of it, yes. Not only have they failed to clean up illicit file-sharing, but they face an explosion in the illegal "burning" of music on to CDs, much of it from digital computer files. Over a third of all CDs and cassettes around the world are pirate copies, according to the IFPI, an organisation that represents the record industry worldwide, with recordable CDs the fastest-growing pirating format.

This was battering the industry even before the economic downturn. In the first half of 2001, music sales worldwide fell by 5% over the same period of 2000, after five already-flat years. Profits at Warner Music, part of AOL Time Warner, were down by 21% compared with the first half of 2000, making music the media giant's worst-performing division. Bertelsmann, a German media group, recently revealed that BMG, its music subsidiary, had lost money in the year to June.

Now, matters look even worse. Music sales will drop by 5.5% in 2001, according to Merrill Lynch, an investment bank. Britain's EMI, one of the big five, gave warning last month that full-year profits would be 20% lower than last year.

Yet, dire as all this is, the record industry may now be better positioned to reinforce its grip on the Internet. Its online subscription services are soon to open for business. On October 9th the industry reached an agreement with music publishers over the payment of royalties to songwriters whose work is distributed online. This removes a big obstacle to launching both MusicNet—backed by EMI, AOL Time Warner and Bertelsmann—and pressplay—backed by Sony Music and Vivendi, which owns Universal Music.

MusicNet, which is a wholesaler, has now delivered its technology to the online retailers, AOL and

RealNetworks, which will each sell music through Internet subscriptions. For its part, pressplay will sell music direct to consumers, and dictate pricing across its affiliated outlets, such as Yahoo!, MSN and MP3.com.

Only when these services come online, probably next month, will it become clear whether the industry can wean users off free, illegal file-sharing. The new services will succeed only if their offerings are cheap and as easy to use as Napster. As Jay Samit, EMI's head of new media, puts it: “My job is to make buying music easier than stealing it.”

The trouble is that, at least initially, the underground versions will still be better. Crucially, users of the new subscription services will be able neither to burn digital files on to CDs, nor to transfer them to portable devices. The industry recognises this drawback. Both pressplay and MusicNet say they will offer some of these functions once they can do so securely. MusicNet, for instance, says that within five months it will allow subscribers to share files, each of which will be encrypted. So far, EMI is the only record major to have licensed its music to both MusicNet and pressplay.

Because of these flaws, analysts expect early take-up to be limited. The services “clearly won't be profitable initially,” says Brett Hucker, an analyst at Merrill Lynch. He forecasts that overall music revenues will not start growing again until 2003, with the recovery driven by online sales.

Even as the industry fights back with technology in one hand, it continues to wield the law in the other. In the first half of this year, the Recording Industry Association of America's anti-piracy unit seized 1.3m illegally recorded CDs, a 133% increase on the same period in 2000. On October 2nd the RIAA filed a lawsuit against MusicCity, Grokster and FastTrack. Its case against Napster continues—though, ominously for the majors, the judge this week raised antitrust concerns about their new subscription services. Such worries might make it harder for the industry to defeat underground operations using its weapon of last resort: buying them out.

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Sun Microsystems

Stealing each other's clothes

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Sun's battle with IBM raises questions about its long-term strategy

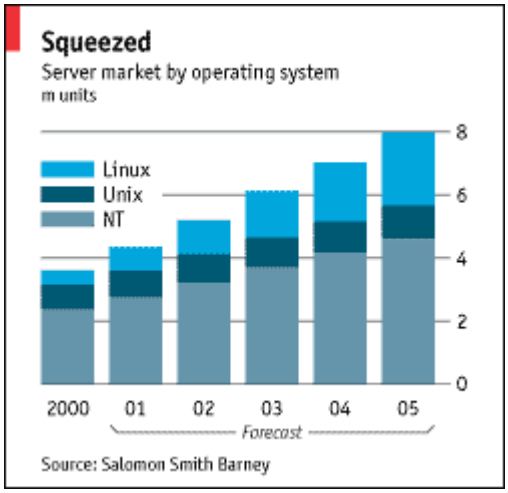
NOW is a tough time to be a computer maker. Sun Microsystems, along with its rivals, has had to go “to warp speed and then back”, Scott McNealy, its chief executive, said last week, as Sun announced that it would make a larger-than-expected loss in the current quarter and would lay off 3,900 workers. At least the competitive landscape is simpler, he added. With much uncertainty surrounding the merger of Hewlett-Packard and Compaq, those big companies that need to buy high-powered computer equipment now face a straight choice between Sun and IBM. The struggle between these two companies has intensified in the past few weeks, with each trying to move on to the other's turf.

Sun is the leading manufacturer of powerful server computers that run the Unix operating system. These account for some 60% of the $60 billion server market. Sun's strategy is centred on its Solaris software, which is regarded as the most stable and powerful version of Unix, and on its UltraSPARC chips. On September 25th, Sun launched its most powerful computer yet, the Sun Fire 15K, which is intended to compete directly with the mainframe computers that dominate big companies' data centres.

Sun is moving upmarket for a number of reasons. At the low end of the market, it faces increasing competition from servers running either Microsoft's Windows NT software or Linux, the free, open-source version of Unix. Internet firms, which bought a lot of Sun's mid-range servers in recent years, have all but vanished. High-end customers are more reliable, and more likely to buy pricey extras such as storage systems and consulting services.

Another reason why Sun is attacking the mainframe market is the growing trend towards replacing entire rooms full of servers (many made by Sun) with a single powerful machine (usually an IBM mainframe). The advantage of using one large computer instead of many smaller ones is that it is faster, cheaper and easier to maintain, and more flexible. As a result, says David Mastrobattista of the Giga Information Group, IBM's mainframe business has been booming. Sun has its work cut out to compete with IBM's mainframes, he adds, because replacing a mainframe with a high-end Unix server is much harder than replacing lots of Unix servers with a mainframe.

Just as Sun is attacking IBM's stronghold, IBM is also attacking Sun's. On October 4th IBM unveiled a mid-range Unix server, called Regatta, that incorporates technology borrowed from its mainframes. Predictably, both firms claimed that the other was stealing their clothes. But such bickering aside, the fact remains that Sun faces a long-term threat: it risks being squeezed between cheap servers running NT and Linux at the low end and mainframes, which can now also run Linux, at the high end. Within IBM, employees joke that “Sun is dead, it just doesn't realise it yet.”



As the world's leading server vendor, Sun is not in any immediate danger. Even as NT and Linux become more popular, its Solaris franchise will continue to be hugely lucrative; although its share of the market may fall, revenues should continue to rise. But there are some contradictions in Sun's strategy, and in its attitude towards Linux in particular. On the one hand, Linux is a convenient stick with which to beat Microsoft, Sun's arch-rival in software. On the other, as the leading Unix vendor, Sun has the most to lose if Linux becomes the standard server operating system, from low-end boxes to mainframes, as IBM expects.

Simon Phipps, Sun's “chief technology evangelist” (yes, really), insists that Sun loves Linux, and that IBM's embrace of Linux is merely marketing camouflage to divert attention from its many incompatible product lines. But while Sun supports Linux in a number of ways, its desire to protect Solaris means that its support is half-hearted. This does not sit well with Sun's attempt to present itself as a champion of open standards. Nor does Sun's insistence on using its own processor chips, while the rest of the industry moves towards Intel's new Itanium chips. By remaining wedded to Solaris and UltraSPARC, Sun appears to be taking the same proprietary route that other computer makers, such as Silicon Graphics and Apple, have already followed into obscurity.

None of this presents an immediate problem. Sun may be losing money at the moment, but it still has plenty of cash. Moreover, Linux is still some years away from being a match for Solaris in high-end Unix servers. But eventually it will be. At that point Sun will have to work out how to square the circle of championing open standards without destroying its competitive advantage.

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Schneider/Legrand

A shocking denouement

Oct 11th 2001
From The Economist print edition

Why it does not pay to second-guess Europe's antitrust regulators

RARELY has a merger been so accident-prone. When Schneider announced its *euro*7.2 billion ($6.6 billion) takeover of Legrand, a local French rival, in January, it created the world's biggest maker of household electrical equipment and won plaudits for reshaping an industry. From there it has been downhill all the way. A bust-up in the spring led to legal challenges from holders of preference shares, forcing Schneider to add a cash sweetener to its all-share offer. That was as nothing compared with the knock-out blow this week: the European Commission blocked the deal, claiming it would harm competition.

This would be bad enough in any circumstances. What makes it disastrous for the companies is that they have already merged. They will now have to prise themselves apart, with great difficulty and at great cost. They had charged into each other's arms, confident that regulators would wave the deal through. But executives grossly underestimated the concerns it would raise, and they were also caught out by a legal quirk: in France, merger agreements cannot be made conditional on antitrust approval.

Things started to go wrong in September when the commission's experts latched on to the new company's dominant position in various national markets for such things as circuit breakers, which are required by law in homes and factories. The regulators had taken soundings from Schneider's rivals, such as Germany's Siemens, which argued that the merger would lead to higher prices. Schneider then offered to sell businesses with turnover of *euro*400m, and lobbied frantically to salvage the deal. So did France's politicians, who had been looking forward to the creation of a new national champion: President Jacques Chirac even put in a call to Romano Prodi, the commission's president. He received the same polite but firm reply as those American politicians who pressed the commission on behalf of GE and Honeywell earlier this year.

Schneider is clearly shocked by the decision, calling it “incomprehensible”. It claims that the commission gave no hint that it would object on principle—a charge that Mario Monti, the competition commissioner, has strongly denied. Schneider's options are now equally awful: either to sell Legrand to a rival, or to relist it on the stockmarket. Analysts calculate that Schneider is likely to lose *euro*2 billion-3 billion on the sale, even if regulators give it a few months' breathing-space. The commission has not completely ruled out renegotiation of the deal, though few think this likely.

Once they break apart, Schneider and Legrand will both become takeover targets. Possible buyers include Tyco and Emerson, both American. Siemens is less keen to expand in this area, but it may be tempted by a fire-sale price. There is even talk of a bid from GE or Honeywell. It would be ironic were Mr Monti inadvertently to help either of the duo whose marriage plans he broke up so spectacularly only a few months ago.

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Corporate Switzerland

A chill in the Alpine air

Oct 11th 2001 | ZURICH
From The Economist print edition

Does Swissair's failure signify deeper flaws in Switzerland's business culture?

EPA

A flag-carrier with a future

IN ITS heyday, Swissair was a pretty good symbol, both of Switzerland's self-esteem and of its reputation for efficiency, profitability and pathological punctuality. Now the company is being propped up by Switzerland's biggest banks, and recriminations about its sorry state are flying more often than its aeroplanes. Even so, in one respect Swissair is something like its reliable old self: as a metaphor for the state of Swiss business.

Stunning as Swissair's demise has been, it is only the latest in a series of scandals, boardroom battles and other embarrassments that have struck Swiss companies this year. In March, Vontobel, a private bank that has been making inroads into investment banking, sacked three top executives after an Internet-banking plan went expensively awry. These included the chief executive, Jörg Fischer, who remains chairman of the Swiss stock exchange. Then the chairman of Kuoni, Switzerland's largest travel company, was booted out after a long boardroom fight, during the course of which security guards stopped him taking his seat at the annual shareholders' meeting.

Other companies have lost the art of making money. On October 8th, Zurich Financial Services, a big insurance group, issued a profit warning. To be expected, after September 11th? Yes, but it was Zurich's third such warning in recent months. The next day, Credit Suisse, the country's second-biggest bank, announced that it had made a loss in the third quarter. Its investment-banking subsidiary, Credit Suisse First Boston (CSFB), continues to be a cost drain; CSFB's new American boss, John Mack, is planning more hefty job cuts. The investment bank is also writing down, by SFr400m ($247m), the value of its 5% stake in Swiss Life, an insurer whose share price fell by some 40% in the third quarter; and it is putting aside SFr200m to cover loans to Swissair.

Fun and games elsewhere have also raised some big questions about Swiss corporate governance. In May, Martin Ebner, a financier who has long been a thorn in the side of the Swiss business establishment, sold his stake in Roche, a pharmaceutical group, to Novartis, a competitor. Despite having 20% of the voting shares, he had failed to get a seat on Roche's board, a hard task when the Hoffmann and Oeri-Hoffmann families, with just 10% of the equity, own a narrow majority of the voting shares. Also in the spring, an attempt to launch a takeover of Sulzer, another quoted, family-controlled group, foundered, partly because of similar restrictions on voting rights.

The doom and gloom should not be overdone. Up to a point, the recent unhappy run is the flipside of Switzerland's extraordinary success. A country of only 7m people has produced a mighty crop of big multinational companies: try naming an Austrian, Belgian or Portuguese company to rank with a Swiss bank, insurer or pharmaceutical company. That inevitably means a disproportionate share of bad news as well as good. Moreover, some Swiss giants, such as Nestlé, a food manufacturer, and Novartis, are doing well. And as far as the treatment of minority shareholders is concerned, Switzerland is no worse than Germany, France, Italy or the Netherlands.

Punching above its weight

In any case, a lot of the old complaints about the Swiss way of running companies are losing force. Although old friends still sit on the boards of each other's companies, the network is much thinner than it

was. Supervisory boards are getting smaller: companies feel less obligation to include representatives of the country's three main linguistic groups (German, French and Italian), both main strains of Christianity and both sexes.

At the same time, management and supervisory boards now contain more foreigners. Luqman Arnold, head of the executive board of UBS, the country's biggest bank, is British; three more non-Swiss sit on UBS's ten-strong supervisory board. Even the Swiss stock exchange has gone global: in June this year, its merger with a British firm, Tradepoint, to form virt-X, an international London-based electronic exchange, took effect.

A new code of corporate governance is being drafted, with some similarities to Britain's much-admired “combined code”. It proposes, among other things, to keep supervisory boards as small as possible and to make them responsible for overseeing the riskiness of companies' activities. Some firms may resist the new code, as much out of resentment at being told what to do as at its content. It stops short of recommending that supervisory and management boards should have different chairmen: Zurich's Rolf Hüppi, for instance, does both jobs, as do the bosses of Novartis, Roche and Credit Suisse. Still, one effect of recent goings-on has been to strengthen the argument for better corporate governance.

Fine, but new guidelines can help only so much. They cannot create competence or stop supervisory boards being dozy. And the recent troubles of some big Swiss businesses have plenty to do with competence—or, rather, the lack of it. Swissair failed above all because it followed a catastrophic strategy of expansion via minority stakes in rival airlines.

Might things get worse still? One seasoned Swiss investment banker thinks that his country's reputation for “consistency, loyalty and the rule of law” has been badly tarnished. One scandal-hit company, he says, was turned by unchecked management greed into “a self-service store”. As for UBS and Credit Suisse, now claiming credit for coming to Swissair's rescue, he suggests that in their haste, they hurt their reputation with other creditors. Says the banker: “Whenever you deal with them, you'll need a lot of lawyers.”

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Face value

Soap-box salesman

Oct 11th 2001
From The Economist print edition

Niall FitzGerald is well placed to take on anti-corporate activists—and his own staff

.xvpics

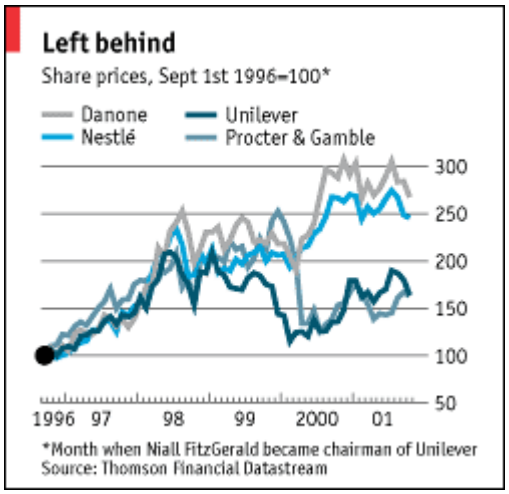
UNILEVER'S Niall FitzGerald doesn't seem the sort to worry much about soap or low-fat spread. Not that the boss of the Anglo-Dutch consumer-goods giant is anything but perfectly groomed and trim. He does, after all, run six miles to work most days, in training for the New York marathon. But the 56-year-old Irishman, who has spent his career at the company behind brands such as Persil detergent and Flora margarine, seems to be more a man of causes than of groceries. From criticising Britain's reluctance to join the euro to giving speeches accusing advertising agencies of failing clients, Mr FitzGerald is as at home standing on soap-boxes as Unilever is at filling them.

It is not uncommon for dynamic bosses of unglamorous companies to seek more glory elsewhere. But Mr FitzGerald's passions are rare for the (usually faceless) head of a multinational. Far from being only an occasional campaigner, he has been consistently left-leaning, as well as strongly supportive of European integration.

The son of a customs officer and a journalist, Mr FitzGerald, like Shakespeare's young Prince Hal, was able to accept and flout rules. He was “a child of the 60s, with hair down my back, drawn to the hippy culture of ‘make love not war',” he remembers, and “one of the few people alive to have seen the Beatles at the Cavern.” At University College, Dublin, he joined the Communist Party and sat at the knee of Noel Browne, a former Irish government minister who fought the Catholic Church to give free medical education to mothers and children.

Having accidentally landed a job at Unilever—he went to support a friend interviewing there—Mr FitzGerald was pragmatic about donning a suit. “I was taught that to change the world, you must get to the top and do it from within. I'm a practical left-winger,” he says. From the start he tested the establishment. He asked for a Yamaha motorcycle instead of a company car “to see if they would bend the rules”. When they did, he turned the bike down. As head of Unilever South Africa, he insisted, against opposition, on unsegregated toilets.

Leftish credibility has helped him to build Unilever too. When Ben & Jerry's, an ethical ice-cream firm, refused to sell to him last year, Mr FitzGerald was livid, “not because they said no, but because they had misunderstood us”. He flew to America armed with tales of Unilever funding hospitals in Vietnam and schools in Ghana—and changed their minds.



Citizen Niall

These days, being a good corporate citizen matters. Business is under growing scrutiny for such alleged misdeeds as exploiting cheap labour or being indifferent to the environment. Anti-globalisation protesters have been rather on the back foot since September 11th. But companies that have in the past arrogantly dismissed their concerns as irrational or minority views have paid, as did Coca-Cola, Nike, Ford and Monsanto, with falling share prices, profits and even their chief executive's jobs. Nestlé is still boycotted by some consumers for pushing its powdered milk in Africa when breast milk was safer.

This is the kind of publicity that Unilever, an equally high-profile multinational company, needs to avoid at all costs. Having a boss who is not only aware of the debate on corporate social responsibility, but sincerely engaged in it, is a good defence.

A dose of cultural sensitivity helps internally too. Unilever, once tagged “the world's most boring company”, is a sluggish, 300,000-strong bureaucracy, badly in need of change. Sales growth has been poor even by the uninspiring standards of its peers: 2% a year on average since 1997, below that of Nestlé, Danone and Colgate-Palmolive. One historical reason is its mature food business, which lags behind its home & personal care division. But the real problem is lack of innovation. Unilever's portfolio of 1,600 brands is expensive to market and has few big winners. Whereas Unilever, with turnover of *euro*52 billion ($48 billion), has just seven brands with annual sales of more than *euro*1 billion, PepsiCo, with half its sales, has 14.

Mr FitzGerald understands the problems and has not shied away from action. His “path to growth” five-year plan—remember, this is a former communist—aims to lift margins and sales growth by cutting the stable of brands to 400 big names by 2004. He has also made some acquisitions. On top of Ben & Jerry's, he has bought Slim-Fast, whose diet drinks will soon become Unilever's eighth-biggest brand, and Bestfoods, owner of Knorr and Hellmann's, now two of Unilever's seven biggest brands.

For all that, Mr FitzGerald has moved at a measured pace. He launched “path to growth” only three years after taking over the top job in 1996, and the big deals did not come until last year. This contrasts with the bulldozing approach of Durk Jager, who tried to turn Procter & Gamble, an American rival, into a hotbed of innovation in his first 18 months as chief executive—and ended up merely sowing confusion, raising costs and losing his job. In the constant battle between fostering too much change (at the risk of creating turmoil) and being content with too little movement (which leads to stagnation) Mr FitzGerald seems to be getting the balance about right.

There is, though, a drawback to moving so deliberately. The daily job of running a stately consumer-goods company is hardly the most exciting of tasks. Asked if watching sales inch up motivates him to go to work each morning, Mr FitzGerald winces: “Oh, that's cruel.” But the challenge of lifting Unilever to a higher plane of performance is real. Moreover, there are taxing longer-term structural questions to ponder, such as whether to split the food and non-food parts of the empire. It may not be storming barricades. But for a practical revolutionary, it seems enough for now.

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Japan's banks

Out for the count

Oct 11th 2001 | TOKYO
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As the problems of Japan's devastated banks get even worse, is serious reform at long last unavoidable?

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JAPANESE banks have long been teetering on the brink of disaster. Over the past ten years there has been much talk about fixing them, and even occasional action, and yet bad debts have continued to rise. Now, in the aftermath of the terrorist attacks of September 11th, a further deterioration in Japan's economy, and with it the value of the banks' loans, has put reform back at the top of the agenda. Might something decisive and effective be done at last—and what should it be?

The big banks have little capital left to cover fresh losses. Officially they have ¥23 trillion ($192 billion) of core capital. More plausible estimates suggest that their true capital was closer to ¥10 trillion in March. Since then, plunging share prices have wiped out a further ¥5 trillion. At the same time, bad loans have continued to soar, not least because deepening recession is dragging ever more firms into trouble.

According to official estimates, some ¥61 trillion out of ¥340 trillion of loans made by the big banks are to “problem borrowers”. For the banks as a whole, loans to problem borrowers are officially ¥150 trillion; but a recent estimate by Goldman Sachs suggests that the true number could be as high as ¥237 trillion. Many bad loans may be unrecognised by banks because, with interest rates close to zero, most companies can pay their interest, and banks prefer to roll over debt rather than admit that the borrower has no realistic chance of repaying the principal. Owning up might reveal that the big banks were, in effect, insolvent.

The scope for disguising bad performance is now smaller, thanks to new mark-to-market rules that took effect in September. These require banks to value their shareholdings at market, rather than book, value. Worried investors are rapidly selling bank shares. Mizuho Holdings, Sumitomo Mitsui Bank and Mitsubishi Tokyo Financial Group, the three biggest, all hit new lows this week.

Where the money isn't

In other banking crises, including the collapse of America's savings and loan associations (thrifts) in the 1980s, a simple but effective model has usually been adopted. The banks are cleaned up by the government taking over the bad loans and then selling them on to investors. Thus purged, some banks are shut; the survivors, recapitalised, then resume their vital economic task of credit creation and allocation, usually with new managers and shareholders as the price for their rescue. However, in Japan, where the scale of the problem dwarfs any other banking crisis, this approach has not been seriously attempted. Policymakers are considering several alternative approaches—though none can yet be described as a likely option.

Since 1997, when politicians started to realise the scale of the bad-loan problem, only three big banks, and a handful of smaller ones, have gone bust. The government delayed the day of reckoning with a capital injection of ¥7.4 trillion in 1999, and by allowing the defensive mergers of the past year or two that have created Japan's four mega-banks. The government has made a modest attempt at taking over bad loans through the Resolution and Collection Corporation (RCC), a public body created in 1999 and

largely financed by the Bank of Japan. Some politicians now argue that expanding the role of the RCC is the way to save the banks.

So far, though, the RCC has spent a mere ¥1 trillion on bad loans. It has not done more mainly because banks are unwilling to sell—and in Japan, unlike countries that have successfully reformed their banks, they have been allowed to get away with not selling. The RCC is supposed to pay only the market value of bad loans, but banks are reluctant to accept this as, at a typical 5% of face value, it would mean that they had to record a big loss.

Recently, some politicians have argued that the RCC should start paying well above the market price—namely, face value less any reserves set against the loans (a formula that, perversely, would discourage banks from making any future provisions against bad loans). This idea appeared to have been scuppered last week, when Junichiro Koizumi, the prime minister, said that all RCC purchases should be at market price—until it emerged that his definition of market price is way above the prices that the RCC has paid until now.

Paying over the odds for bad loans could be a way quietly to recapitalise the banks, so long as it was accompanied by hard decisions about saving those that are the least bad and closing the worst. But so far the government has shown no inclination to make such choices. Without them, voters could react badly to a back-door injection of public funds if bank bosses and shareholders did not take responsibility for their mistakes.

The government could choose simply to pump in, by the front door, the ¥15 trillion of public funds set aside for a banking “crisis” (which happens officially when the prime minister declares one). Such a public step would probably give the government no option but to force some executives to resign and to wipe out shareholders' equity in return for the fresh capital. Yet even ¥15 trillion, although it is twice what the government pumped into the banks two years ago, would not erase the mountain of bad debts. More likely, it would simply defer serious reform for another day.

Another plan that is now fashionable among politicians is championed by Takeshi Kimura, president of the KPMG consultancy in Japan. This would require banks to make adequate provisions against the bad debts of the country's 30 most financially precarious big firms. Banks had made practically no provisions against loans to Mycal, a big supermarket chain, before it went bust last month.

In the June issue of *Foresight*, a monthly magazine, Mr Kimura seems to suggest that doing this would largely solve Japan's bad-debt problem—which is why his idea appeals to politicians desperate for a relatively painless cure. But he has recently clarified his position, explaining that not only are the 30 companies likely to differ between banks; the number could also range between, say, ten and 50 for each bank. Moreover, making provisions against these loans would only be a first step towards solving the banking problem. By forcing banks to tackle these household names—and perhaps throwing in some public funds—the government could show that it was serious about reform.

The most extreme and, in some ways, the most attractive option would be temporarily to nationalise the banks. The government could then separate bad assets from good, appoint new managers and reprivatise the cleaned-up bits by selling them to investors (ideally, including some foreigners). Despite ballooning public borrowing, the government's balance sheet is still just about strong enough to take on such a task.

The obvious danger is that temporary nationalisation would, in practice, become permanent, perhaps worsening the situation by putting the government behind the banks without securing any real reforms. Indeed, some observers argue that the banking system is already, in effect, nationalised, with government policy doing all it can to keep banks alive by allowing them to ignore problems for as long as possible while obstructing attempts by some banks to heal themselves.

To many bankers, particularly foreigners who have been keeping an eye out for opportunities in Japan, the government's inclination to obstruct reform has been sharply illustrated by last week's order by the Financial Services Agency, a regulator, to Shinsei, a bank now owned by foreign investors, to increase lending to small and medium-sized companies. This would surely weaken the finances of Shinsei, which has been trying to introduce the alien concept of profit maximisation into Japanese banking, and could scare off other foreign investors. However, the FSA argues that Shinsei had agreed to increase this sort of lending in return for a ¥240 billion injection of public money last year.

This being Japan, politicians will no doubt try to carry on talking about reform, instead of doing it. But will

events finally force the government's hand? Banks and their borrowers are getting weaker, moving closer to the crisis that politicians want to avoid. There are rumours of several large corporate bankruptcies, possibly only days or weeks away, that could produce a long overdue bout of honesty in the banking system, and leave the government with no choice but to act.

Yet some of those companies that are most likely to go bust have been defying the doom-mongers, seemingly miraculously. Letting them go would be painful. But it may be a necessary precursor to reforming the banking system—and thus a big step towards putting the Japanese economy back on its feet.

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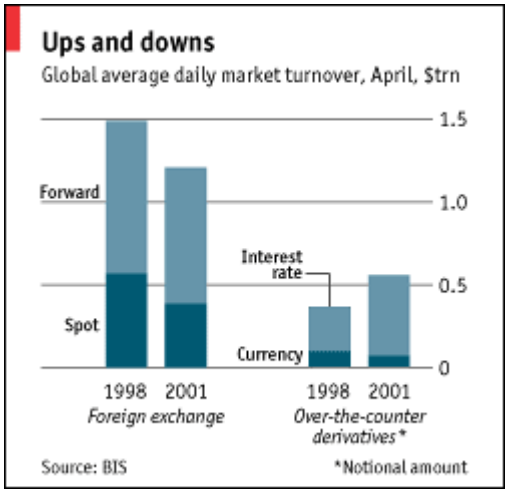
Derivatives and foreign exchange

Global swap shop

Oct 11th 2001
From The Economist print edition

London is still the hub for foreign exchange, and even more for derivatives



FOREIGN-EXCHANGE traders, once the pride of the City of London, were knocked off their pedestals when machines began replacing them a decade ago. Then came the euro, which has bashed 12 European currencies into one and decimated forex dealing rooms. But despite lower volumes, 19% less than three years ago, London remains the world's leading marketplace for currency trading, with nearly a third of global turnover being booked there, according to a triennial survey by the Bank for International Settlements (BIS). As forex has declined, so other products have taken its place, keeping London as the leading international financial centre.

Many of London's currency dealers have retooled themselves to trade more sophisticated products, such as interest-rate swaps and forward rate agreements. London now has a 36% share of this still growing global market.

Even in the jaws of recession the swaps market, now 20 years old, shows no sign, at $331 billion a day, of hitting a ceiling. The euro has given it fresh impetus—euro swaps now outstrip dollar swaps by 73%. Wholesale trading in Europe, which used to be mostly based on currency bets, is now a game of credit and liquidity risk, expressed in interest-rate spreads. Germany has a 13% share of total derivatives volume.

The BIS survey shows a 24% fall in inter-dealer foreign-exchange trading, and a 35% drop in business with non-financial firms. Business with financial firms, such as insurance companies and investment funds, rose by 18%. The fall in inter-dealer business can be explained by three things: the disappearance of euro-area currencies, consolidation among dealers, and an increase in electronic trading. Anonymous electronic trading on the Reuters and EBS systems reduces the need for dealers to cover their tracks with multiple or inflated trades. Machines may yet cut into the trading of standardised interest-rate products. But so far electronic clearing of over-the-counter swaps and bond borrowing deals is having the opposite effect.

As for the next few years, a big unknown is the much-delayed launch of CLS Bank, which from next year is due to become the settlement counterparty for trades in major currencies between the world's 60 largest banks. If it is a success, it will affect trading patterns in foreign exchange and perhaps other instruments. But whether volumes will balloon or shrink is anybody's guess.

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American banking

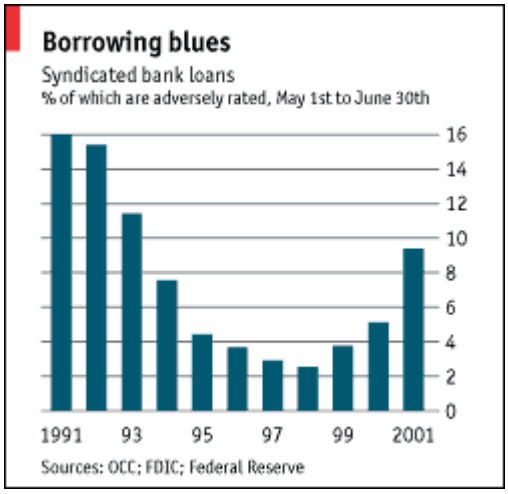
An old economy crunch

Oct 11th 2001 | NEW YORK
From The Economist print edition

Investors in shares bore the initial brunt of America's downturn. Banks are next

SO FAR, America has managed to deflate an investment bubble with surprisingly little damage to the traditional core of a country's financial system, its banks. Dotcoms and other absurdly overvalued firms had no collateral to offer, so rarely got loans. Unlike Japanese banks, few American banks own shares, so their capital was not directly depleted by the fall in share prices. Thus America has entered the downturn with its lenders broadly intact. They are now being put to the test.

On October 5th the three main national bank regulators (the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) released their annual report on shared national credits, or syndicated loans. This is based on a detailed examination of the country's biggest banks. The results were not encouraging. In 1998 some 2% of overall bank loan commitments were “adversely rated”. That rose to 5% in 2000, before the economy showed any signs of stress. The latest report shows another big increase (see chart). Almost $200 billion, or nearly 10% of commitments, were cited as troubled to varying degrees. Moreover, the exam ended in June, before the economy turned really bad.



Release of the report had been delayed by several weeks. Concern about the results may have contributed to the recent decline in share prices of many of the banks with a large presence in syndicated loans, notably J.P. Morgan Chase, but also Fleet, Bank of America, and Wachovia.

When the last cycle bottomed in 1991, the shared national credit study cited 16% of loans as having serious problems. The recent rate of increase suggests that that number could be reached next year. Yet concern remains muted.

Consolidation and restructuring have resulted in a stronger banking industry, says Diane Glossman, an analyst at UBS Warburg. The average return on assets is 1.2%, compared with 0.5% in 1989. Capital strength has similarly improved. Banks that originate syndicated loans are better at placing them outside the American banking system. Foreign banks hold 41% of the syndicated loans; “non-banks”, such as mutual funds, hold around 10%.

Unlike earlier recessions, banks started tightening their standards before the economy began contracting, which will spare them much potential pain, says Ms Glossman. And the Fed has been generous, cutting interest rates sharply since the start of the year, which for banks means a lower wholesale cost for its main product: money. With today's steep yield curve, they can lend at much higher rates than they can borrow, earning a decent spread.

The good news, though, goes only so far. As part of the latest exam, banks had to scrutinise all their loans and regrade those that had become riskier, which, given the slowing economy, should mean most of them. They will thus have to put aside more capital, and cut lending. Customers may then experience a credit crunch.

Even if America were to have a v-shaped recovery, starting immediately, there would probably be another year's worth of deteriorating loans, as austerity measures taken by large companies have knock-

on effects on the rest of the economy, says David Gibbons, a deputy Comptroller of the Currency. If recovery is not swift, things could be much worse.

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American securities markets

Financial schizophrenia

Oct 11th 2001 | NEW YORK
From The Economist print edition

Shares and junk bonds are sending out different signals. Which to believe?

NOWHERE is the remarkable uncertainty gripping America's markets more evident than in their schizophrenic valuation of fragile companies. Dozens of such firms have bonds now trading at, or close to, levels that suggest their imminent bankruptcy. Meanwhile their shares, which would normally be the most worthless securities in a default, suggest that the firms still have substantial value. This divergence has increased dramatically since the terrorist attacks of September 11th.

The most striking examples among firms with debt trading at (often much) less than 70 cents in the dollar are Nextel Communications, with a stockmarket capitalisation of $6 billion, Amazon ($3 billion), and Amkor Technologies, Conseco and Energis (all around $2 billion). Many industries are displaying a split financial personality—from airlines (Continental and Northwest), metals (Bethlehem Steel) and prisons (Correction Corp), to casinos (Trump Holdings) and telecoms (Level 3 Communications, Global Crossing, Colt Telecom).

Because bond investors do not usually earn more from their investment than their coupon, they inevitably worry more about getting their principal back than investors in shares, whose potential upside is limited only by a company's ability to earn profits in future. As a result, one interpretation of the price divergence is that, while equity investors know that things have got worse, they remain more willing than junk-bond buyers to take a longer-term bet in the hope of achieving a huge reward.

Another possibility is that bond investors have simply lost their nerve. Supporting this view is the fact that new issuance in the junk-bond market has more or less ceased, regardless of the terms offered.

Steven Tananbaum of Goldentree Asset Management, an investment firm specialising in junk, argues that sometimes the greater resilience of shareholders compared with bondholders is soundly rooted because the operating leverage is so large (for instance, in airlines). A return to anything like former business conditions could turn losses into profits and push up share prices many times over. Bondholders would capture only some of these gains, while still being exposed to large risks.

Often the opposite is true, says Mr Tananbaum. It is possible that the price of bonds of the better telecoms firms, such as Telewest and Nextel, could double in the next two years even though they pay yields well in excess of 20%, a gain usually associated only with the best years of venture capital, not boring old bonds.

The bond markets suggest that many of today's fragile companies will fail. The stockmarket is betting they will survive. During previous periods of financial schizophrenia—most recently in 1991—the divergence of opinion between share and bond markets proved shortlived, as it quickly became clear which approach to valuation was right. The fear generated by recent events has produced huge uncertainty. When this fog is replaced by hard facts, will bonds or shares have prevailed?

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Credit cards

Guilty as charged

Oct 11th 2001 | NEW YORK
From The Economist print edition

MasterCard and Visa are found guilty of restricting competition

IF AMERICANS can find a moment between the solicitations from credit-card companies that come by phone during every meal, by letter in every mail delivery, or at the cash register on every shopping trip, they will now have the chance to ponder still more credit-card pitches at their local bank. They can thank a New York court decision of October 9th.

Visa and MasterCard were created by banks and are now run by associations with overlapping membership. As a condition for offering their cards, though, banks are restricted from providing alternatives. This arrangement, the court ruled, is a limitation on competition at the “network level”, if not the issuer level. This has long rankled with the two big rivals to MasterCard and Visa—Morgan Stanley's Discover card and American Express—although it has not stopped either from successfully distributing their products.

In her ruling, Judge Barbara Jones said that Visa and MasterCard “weaken competition and harm consumers” by damaging the competitive strength of American Express and Discover cards. This undermines their ability to provide innovations such as “smart cards”, as well as preventing consumers from combining the unique benefits of their preferred banks with their preferred card at the same time.

If the decision survives appeal, it will have big long-term implications. American Express has been successful at issuing cards through banks overseas, says John McDonald, an analyst with UBS Warburg, and it could do the same in America. It will also allow American Express to buy credit-card portfolios and make it a more plausible merger partner for a bank.

Although the decision was a blow to Visa and MasterCard, it may not be particularly damaging for the banks that own them. They have become increasingly sophisticated at segmenting customers. Traditionally, American Express has been used by people who spend lots of money (generating fees from merchants) but do not carry interest-charging balances, the primary source of bank profits from Visa and Mastercard. “The dominant credit-card issuers, First USA, MBNA and Citigroup, face a stronger competitor today than yesterday, but they are also prime candidates for partnerships,” says Mr McDonald. Who knows? Perhaps American Express will join MasterCard and Visa in a cosy new triopoly.

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Art insurance

A museum in the sky

Oct 11th 2001
From The Economist print edition

Although trivial beside the human cost, much art was lost on September 11th

AP

MANY of those who died in the World Trade Centre used to have their days brightened by the enjoyment of the great works of art that hung on many of its walls and filled its public spaces. That art died with them. The value of the works destroyed in the terrorist attacks far exceeds any previous losses. Art insurers, niche businesses that provide cover for museums, auction houses, private and corporate collections, reckon that they will have to pay out millions of dollars in compensation for lost works—a sum well below the true loss, because much of the art in the World Trade Centre was not insured for its full value.

Cantor Fitzgerald, a bond-dealing firm that lost more lives than any other in the tragedy, also suffered the biggest artistic loss. Its offices on the 105th floor of One World Trade Centre housed a collection of sculptures by Auguste Rodin. It is still uncertain how many Rodins were in the building, and thus destroyed. Estimates range from dozens to several hundred.

Fred Alger, an investment-management firm that also had offices in the North tower, lost a collection of photographs by trendy artists such as Cindy Sherman and Hiroshi Sugimoto. More than 100 works of art by contemporary artists at Bank of America's offices were destroyed, says Kelly Devine Thomas at ARTnews in New York. Other than these, no major corporate collection was housed in the twin towers. Merrill Lynch and Lehman Brothers had collections in the World Financial Centre, but these escaped unscathed. J.P. Morgan Chase, a pioneer of corporate art collections in America, has more than 17,000 works of art at its offices two blocks from the WTC, but only five lithographs were in its small office in the centre.

Art works bought for the public were the best known of the lost masterpieces. When the World Trade Centre was built, the Port Authority of New York and New Jersey set aside 1% of its overall building costs for public art. The authority bought a red 25-foot sculpture by Alexander Calder, commissioned the “World Trade Centre Tapestry” by Joan Miro and a painting by Roy Lichtenstein. The only major work of public art in the immediate vicinity of the WTC that has remained intact is Lichtenstein's 30-foot sculpture “Modern Head”.

Estimates for the cost of the art lost in the attacks are still rough. Dietrich von Frank, chief executive of Axa Art in New York, forecasts insurance payments for art in the towers of at least $100m. This may be on the low side, considering that Mr von Frank has put aside $20m to cover gross losses for Axa alone. Axa Art insured three corporate collections at the WTC.

The attack will change art insurance, and maybe even corporate collecting, forever. Shareholders have been grumbling for years that building up an art collection does little to improve a company's return on equity. Art insurance used to be a stable market, with losses rare (mostly through theft or damage in transport) and prices low. Art collections were often insured for only a part of their worth. The chance of total loss seemed negligible. Now collectors will want to insure fully their entire collections. Premiums will rise by 15-25% or more, predicts Hiscox, a British insurer. Hiscox itself sold a big chunk of its art collection in 1997, when it listed on the stockmarket.

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European interest rates

Stuck

Oct 11th 2001
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Can the euro area avoid a recession? With luck—and more interest-rate cuts

EPA

ONCE again the European Central Bank has disappointed financial markets and reinforced the impression that it prefers to fight inflation rather than promote growth. At its policy meeting on October 11th the bank held its refinancing rate unchanged at 3.75%. The ECB joined America's Fed in cutting rates by a half-point soon after the terrorist attacks on America, but given the darkening economic outlook a further cut would surely have been wise.

Both America and Japan are almost certainly in recession already. Some economists worry that the euro area is heading the same way. So there was a strong case for cutting interest rates. Growth has slowed more sharply than expected: GDP growth in the euro area was barely positive in the second quarter, and preliminary evidence suggests there was little growth in the third quarter. Inflation has also fallen faster than expected, from an annual rate of 3.4% in May to an estimated 2.4% in September. J.P. Morgan forecasts that it will fall to 1% by the end of next year. As inflation falls, short-term real interest rates rise, unless the ECB cuts nominal rates.

Furthermore, the euro area has less room than America for a fiscal stimulus. Most governments are already running budget deficits, and the fiscal straitjacket of Europe's stability pact will prevent them from doing much more than allowing automatic stabilisers to operate as their economies weaken. As a result, Europe has to rely on a monetary boost.

Output in the euro area is widely expected to stagnate until next year, yet most economists still reckon that it will avoid a true recession. *The Economist*'s poll of forecasters this month shows that growth forecasts have been revised down by much less for the euro area than for America or Japan. Comparing average October forecasts with those made in September, America's expected GDP growth has been slashed, for 2001 from 1.6% to 1.0%, and for 2002 from 2.6% to 1.0%. The euro area is expected to grow by 1.6% this year (down from 1.8% forecast in September) and by 1.5% next (from 2.2%).

The direct impact of America's recession on the European economies is likely to be modest, because exports to America account for only 2.5% of GDP. But this understates the region's exposure to events abroad. It is not only America's economy that is struggling. As Japan and other Asian economies plunge into recession, they will also import less from Europe. Arguably, a more important and unpredictable international factor will be the impact of the “war on terrorism” on business and consumer confidence in Europe.

The ECB'S task is not made any easier by the disgracefully poor quality of the official economic data. Europe's economic pulse tends to jump around more erratically than America's. For instance, industrial production in Germany leapt by 2% in August. A sign of recovery? No. There were an unusually large

number of holidays in July, which cut output in that month. In fact, it turns out that the underlying trend remains downwards: the average level of German production in July and August was below that in May and June. The rise in Germany's jobless rate to 9.4% in September confirms that the economy remains weak. Unemployment has also been edging up in France.

Another problem with European economic data is its long lags. In America, GDP figures are published four weeks after the end of a quarter; in the euro area the delay is at least ten weeks. Industrial production and retail sales are typically published a month later than in America.

Lacking timely official data, the ECB needs to pay more attention to surveys of business and consumer confidence. The European Commission's survey of consumer confidence in the euro area has fallen further in the past five months than at any time since 1990—but not as sharply as American confidence (see chart). Business confidence has also slumped.

Another useful indicator is the purchasing managers' index, which plunged in September in both manufacturing and services. Both indices (largely based on responses collected before September 11th) dipped below 50, implying that economic activity is contracting.

Any downturn is unlikely to be as deep in the euro area as in America because it is suffering less from the after-effects of economic and financial excess. Europe has seen less over-investment and less borrowing. Fewer households own shares. It is these excesses that leave America especially vulnerable to a sharp downturn. Nevertheless, an overly tight monetary policy could nudge a feeble euro area into recession.

One possible boost to consumption in the next few months could come from the spending of so-called “mattress money”: cash earned in the black economy out of the taxman's sight. Next year, a few weeks after euro notes are introduced, notes in the old currencies will no longer be legal tender. It will be tricky to exchange large wads of D-marks or pesetas for euros without questions being asked. As people spend dodgily earned cash, consumer spending may surge in some countries.

Sadly, there was no sign of such bingeing at this year's Munich *Oktoberfest*. Total beer consumption was 20% lower than last year. The ECB needs to keep pumping more fizz into Europe's flat economies.

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Economics focus

The lemon dilemma

Oct 11th 2001
From The Economist print edition

This year's Nobel prize for economics honours work inspired by a simple observation about used cars

TODAY'S global economy is a colourful landscape. Brands are ubiquitous, sprouting from billboards, television and magazine advertisements that relentlessly tout the virtues of products. Humans themselves are not immune: American business gurus advise aspiring executives to style themselves as a product, “Brand You”. Nowadays, everything seems to be a sales pitch.

But brands do help to make the world easier to navigate. A Coke or a Big Mac, say, is almost the same everywhere in the world. The customer knows the quality of a product by its brand. To understand why brands are so valuable an economic innovation—despite being pilloried by the anti-globalisation lobby—you need only imagine what happens when sellers offer a product whose quality a buyer cannot easily judge.

Take the frustratingly familiar problem of buying a used car. Assume that used cars come in two types: those that are in good repair, and duds (or “lemons” as Americans and most economists call them). Suppose further that used-car shoppers would be prepared to pay $20,000 for a good one and $10,000 for a lemon. As for the sellers, lemon-owners require $8,000 to part with their old banger, while the one-owner, careful-driver old lady with the well-maintained estate won't part with hers for less than $17,000. If buyers had the information to tell wheat from chaff, they could strike fair trades with the sellers, the old lady getting a high price and the lemon-owner rather less.

If buyers cannot spot the quality difference, though, as is often the case in the real world, there will be only one market for all used cars, and buyers will be ready to pay only the average price of a good car and a lemon, or $15,000. This is below the $17,000 that good-car owners require; so they will exit the market, leaving only bad cars. This result, when bad quality pushes good quality from the market because of an information gap, is known as “adverse selection”. This was the simple but powerful insight of one of this year's laureates, George Akerlof, now a professor at Berkeley, in a seminal 1970 paper.

Theories that deal with similar instances of so-called “asymmetric” information—when one party to a deal knows more than the other—link all three of this year's winners. It seems that a great many markets, including those for shares, labour, insurance and banking, often resemble a used-car sale more closely than a McDonald's restaurant.

Sending signals, setting screens

Information gaps can be costly, as whoever has the least information can never be confident about what is being traded. But there are ways to reduce the cost. In used-car sales, for example, sellers with good cars can show convincingly that theirs is not a dud. Or used-car buyers can devise better strategies for spotting the lemons. This year's other two laureates, Michael Spence of Stanford University and Joseph Stiglitz of Columbia, won their prize for analysing how firms and consumers separate the gems from the lemons in a variety of industries.

Mr Spence's early work focused on how individuals use signalling to communicate their abilities in the labour market. Job applicants, for example, want to distinguish themselves from the mass of other hopefuls. They may try to do this in a number of ways, from a fancy suit to a fancy education. But for signals to be believable, Mr Spence observed, they need to differ substantially in their cost of acquisition. For example, for education to work as a credible signal, it must be harder for less able employees to get.

Indeed, even if such an education gives a student no tangible skills—reading classics at Oxford, say—it can still be a useful signal of relative quality to employers.

Signalling is used in many markets, wherever a person, company or government wants to provide information about its intentions or strengths indirectly. Taking on debt might signal that a company is confident about future profits. Brands send valuable signals to consumers precisely because they are costly to create, and thus will not be lightly abused by their creators. Advertising may convey no information other than that the firm can afford to advertise, but that may be all a consumer needs to know to have confidence in it. Perhaps advertising, as a signal, is not money entirely wasted, as some economists argue.

The theory of signalling can also help to explain why companies pay dividends, even though they are less tax-efficient than share-price rises in compensating investors. Dividends, under the signalling theory, serve as a way of highlighting a strong profit outlook.

Mr Stiglitz is the best-known of the three winners, thanks to his outspoken stint as chief economist at the World Bank during the late 1990s. His insights then got plenty of attention, but are not the reason for his Nobel award. Rather, he has been rewarded for theories drawn from the perspective of a used-car buyer—how to get reluctant people to reveal secrets about themselves or their products. For example, how likely are individuals to repay a loan, or to drive their insured car recklessly? He has explained how insurance companies structure their prices to detect the truth about customers, using different deductibles and premiums to classify customers by their level of risk. This sort of screening of customers is also common in the banking industry.

The winners must split the $1m prize three ways, but they are now unlikely ever again to need to use their expertise at buying lemons.

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About sponsorship

The future of contraception

A pregnant pause

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Half a century after women got the Pill, men may get one, too

Get article background

"WOULD you be more careful if it was you that got pregnant?" That was the message on the poster opposite, when it graced the hoardings of Britain in 1969. Sexual intercourse, as Philip Larkin once observed in a poem, began in 1963. And the catalyst of 1960s promiscuity, whether real or just in the imagination of those who thought they were living through it, was the contraceptive pill. This had its origins in a chemical synthesis first carried out 50 years ago on October 15th, in a laboratory in Mexico (see article).

The invention of the Pill marked a shift in the reproductive power-struggle between the sexes. Women could, for the first time, reliably prevent themselves from becoming pregnant. But power goes hand in hand with responsibility, and in the eyes of many that power-loss diminished the responsibility of men (not, perhaps, that high in the first place). Hence the Health Education Council's campaign, six years after Larkin's supposed watershed.

Power may, however, be about to shift again. After years of research, chemical contraceptives for males are now undergoing clinical trials. If those trials work, a Pill for men should become available for those who want it.

The father of invention

The trick required for a male Pill is to switch off sperm generation but at the same time maintain machismo. Biologists have been struggling with this balancing act for longer than the female Pill has existed, but a couple of research groups seem now to have cracked it. Richard Anderson and his team at the Human Reproductive Sciences Unit, in Edinburgh, have been testing a male Pill—or, rather, a daily pill and an injection every three months—on 66 men in Edinburgh and Shanghai.

The pill in question contains a gestogen. This is a synthetic hormone which, as in the female Pill, shuts off production in the brain of those molecules that stimulate the gonads to go about their reproductive business. To counteract an associated shutdown in male-hormone production, the volunteers receive a shot of a slow-release testosterone derivative.

The results are encouraging. The subjects stopped producing sperm within four months of starting the trial. There were no pregnancies among their partners. Their sperm counts returned to normal within four months of discontinuing the treatment. And the short-term side-effects (acne, mood swings and weight gain) experienced by a few of them were irritating, but not life-threatening.

Organon, part of Akzo Nobel, a Dutch firm, is taking the work forward with 120 men, and hopes to have preliminary results next spring. Schering, another drug company, in collaboration with Eberhard Nieschlag's group at the Institute of Reproductive Medicine at the University of Münster, Germany, has also started trials using injectable hormones. Both the Edinburgh and Münster groups are trying to refine their approach with better versions of testosterone and new alternatives to the gestogens and all their side-effects. There is talk of the two companies co-operating.

On the face of it, even such a souped-up male hormonal contraceptive might seem a hard sell. Women may worry about the nasty side-effects of oral contraceptives, but at least they can console themselves with the thought that the risk of death from an unwanted pregnancy or an abortion is much greater. Men have no such comforting rationale, so their tolerance of complications or side-effects is likely to be smaller. However, surveys of 5,000 people in Scotland, China and South Africa, by David Baird and his colleagues in Edinburgh, suggest that between half and two-thirds of the men polled would use a male oral contraceptive and, equally important, that only 2% of the women questioned would not trust their partners to take it.

Sexual chemistry

Dr Baird reckons that a male hormonal contraceptive might be on the market within a decade. In the meantime, a number of other laboratories are working on more sophisticated methods of suppressing male fertility than merely flooding the body with hormones.

One option is to interfere not with the production of sperm, but with their maturation. Trevor Cooper, at the University of Münster, has been focusing on the epididymis. This is a long tube that leads out of the testis, in which newly formed sperm acquire some of their survival skills, such as their ability to swim. Dr Cooper has found that sperm produced by some genetically modified mice, which are missing part of the epididymis, get their tails into such a twist when they enter the female reproductive tract that they travel backwards and cannot hit their targets. Genetic modification of men is not, of course, an option, but understanding what, exactly, the epididymis is doing might allow the development of a chemical to stop it.

David Clapham and his colleagues at Harvard Medical School have also stumbled upon flailing sperm. These cells, described in this week's *Nature*, were collected from mice that had been genetically engineered in a different way, and are missing a protein called CatSper from their tails. As a result, the mutant sperm move sluggishly and cannot pierce the zona pellucida (the thick coating around an egg). Dr Clapham reckons that drugs to block CatSper might prove to be effective contraceptives with few side-effects, since the protein is found only in sperm.

Ladies first?

This plethora of investigations into male genitalia does not mean that researchers are neglecting ways of improving contraceptives for women. On paper, and in preliminary animal tests, there are plenty of bright ideas about how to get in Mother Nature's way. One is interfering with the final steps of egg maturation, so that any eggs released are either immature or past their prime. Another is messing up the formation of new blood vessels in the uterus, so that there is no cosy womb for an embryo to take root in.

A third proposed method is to vaccinate. John Herr and his group at the University of Virginia are among those scanning the human genome in order to find suitable materials for vaccines. The team has already located more than a dozen genes, and their associated proteins, that are active in the later stages of sperm or egg life. Such novel proteins can be used not only to develop drugs, but also as vaccines to stimulate the production of antibodies that will block sperm or egg function. Dr Herr is ready to start human trials of a vaccine against a protein known as LDHC4, that is found in sperm. In female baboons, this reduced fertility by 70%. By combining LDHC4 with other newly found sex-cell proteins, the team hopes to create a vaccine that will improve this rate to near 100% when applied in women.

But the troubled history of contraceptive vaccines shows how hard it is to beat the Pill. Many approaches, such as immunising women against the zona pellucida, have been tried in the past and failed. Moreover, women's rights groups in India and elsewhere have responded violently to the notion of fertility control through a potentially irreversible vaccine, and have rejected the technology just as violently.

In any case, as Dr Nieschlag points out, vaccinating against fertility is trickier than vaccinating against disease. In part, that is because there is no “herd immunity” in reproduction. Although it is enough to protect a group against a virus by vaccinating most of its members, a contraceptive vaccine has to work on every woman and man every time to avoid unwanted pregnancies. No wonder drug companies in the business of contraception prefer to stick to the slow but steady market for hormonal contraceptives, rather than venture into such choppy waters.

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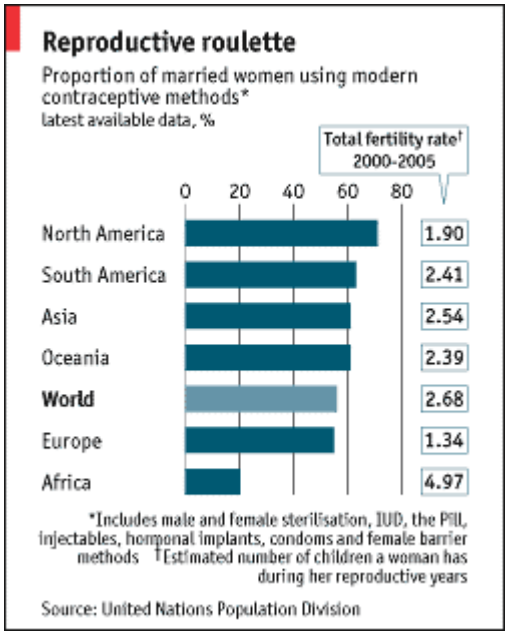
Contraception in poor countries

A fertile future?

Oct 11th 2001
From The Economist print edition

In the developing world, access to existing contraceptives would save lives

Get article background



NEW contraceptives may be desirable. But it would also help if existing ones were distributed to those who need them. According to the United Nations Population Fund (UNFPA), roughly 350m couples lack access to a full range of modern contraceptives (see chart). Millions of others are missing even the most basic knowledge of what is possible. As a result, there are as many as 100m unwanted pregnancies each year. A fifth of these end in unsafe abortion. More than half-a-million women a year die in consequence.

According to Tracy Clarke, of the International Planned Parenthood Federation, improving access to contraception in the developing world will take a lot of money. The contraceptives themselves are cheap. The problem is that aid agencies need lots of them, and donor countries have been cutting their budgets. According to UNFPA, unless donors increase their contributions, international efforts to provide contraceptives to all those who need them will be short of $100m a year by 2015.

Greater political will is also necessary. Poor-country governments need to start thinking about contraception as an essential public-health measure, and to provide money and manpower to ensure a continuous supply in the field. Abolishing such obstacles as heavy taxes on imported contraceptives would help. And access in the developing world would improve even more if the American government rescinded its ban on financing any groups that offer abortion. That ties the hands of family-planning organisations which offer contraception as well as termination.

The provision of old contraceptives and the development of new ones do not yet feature prominently in today's arguments over better access to medicines in the developing world. They should. Fertility is certainly not a disease, but there are millions around the world who are still struggling to avoid pregnancy like the plague.

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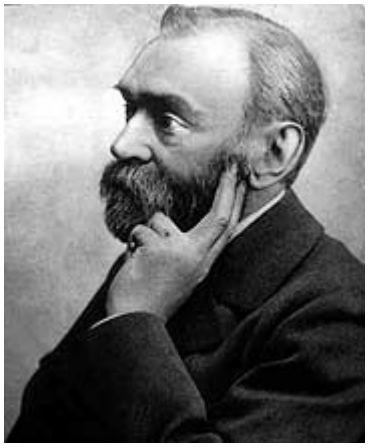
The 2001 Nobel prizes

Playing catch-up

Oct 11th 2001
From The Economist print edition

This year's Nobel prizes were awarded for work on cell division, Bose-Einstein condensates and single-handed catalysts

AP



Still famous, after all these years

WELL, they blew it. The Nobel authorities had a perfect opportunity to give an award that followed the letter of their founder's will ("shall be annually distributed in the form of prizes to those who, during the preceding year, shall have conferred the greatest benefit on mankind"), and they chose not to. There was, in other words, no prize for last year's announcement of two draft versions of the human genome. Perhaps the controversial race between the public and private sequencing projects was too much for the delicate sensibilities of the award committee of the Karolinska Institute, which selects the recipients of the prize for medicine. Perhaps its members could not choose among the numerous claimants (by tradition, a prize is never divided more than three ways). Or perhaps they just wanted to make people sweat. Whatever the reason, the committee relapsed into Buggins's turn, as usual.

Not that the Bugginses in question are unworthy winners. The medicine prize went to three researchers who contributed to understanding of the cell cycle. This is the process of chromosomal duplication and cell division that allows organisms to grow—and, critically, to stop growing. When it goes wrong, cancer may develop (a cancer being a collection of cells that is proliferating in the wrong place at the wrong time).

Leland Hartwell, of the Fred Hutchinson Cancer Research Centre in Seattle, began his experiments in the 1970s, using bakers' yeast. He isolated over 100 genes that regulate various phases of the cell cycle, but the one that was most significant was called cdc28. This turns out to be the "start" gene that kicks the whole cycle off, by permitting a cell to grow to a size where it needs to divide. Dr Hartwell also discovered the existence of "checkpoints" in the cycle. These stop a cell that has damaged DNA from replicating itself, an important anti-cancer mechanism.

Sir Paul Nurse, now director-general of the Imperial Cancer Research Fund (ICRF), in London, followed this work up in a different species of yeast. In the mid-1970s, he discovered a gene called cdc2 in it. This initiates the process of cell division. He then worked out that it was, in fact, the same gene as Dr Hartwell's cdc28, and in 1987 he identified it in human cells (where, confusingly, it is known as CDK1).

Tim Hunt, the third winner, and another researcher at the ICRF, found another type of molecule, known as cyclin, that helps to control the cell cycle. It governs the activity of CDK1 and its ilk by activating and deactivating the proteins that those genes generate. It is this understanding of how the cycle is regulated that creates the possibility of a systematic method of controlling tumours.

An atomic laser

The physics prize went to the first makers of Bose-Einstein condensates. By Nobel standards, this is recent stuff; it was done in 1995. But the winners of the physics prize are chosen by a different institution, Sweden's Royal Academy of Sciences.

A Bose-Einstein condensate is a creature of quantum mechanics. In the quantum world, things traditionally thought of as waves, such as light, can also be viewed as particles. Conversely, things traditionally thought of as particles, such as atoms, can be seen as waves as well. And, just as light waves of the same frequency can be made to resonate in step with one another and so form a laser

beam, it should be possible to make atoms of the same element resonate similarly.

That, at least, was the conclusion of Satyendranath Bose and Albert Einstein, who did the relevant sums in the 1920s, decades before anyone had made a laser, let alone the Bose-Einstein condensate that is named in their honour. Actually creating such condensates fell to Eric Cornell and Carl Wieman, of the University of Colorado, Boulder, who made one out of rubidium atoms, and Wolfgang Ketterle, of the Massachusetts Institute of Technology, who did the same with sodium. Just to prove that his atoms really were acting as single waves, Dr Ketterle made two condensates at the same time, and allowed them to merge, thus creating ripple-like interference patterns of the sort that might be seen if two stones were thrown simultaneously into the same pond.

The usefulness of Bose-Einstein condensates is debated. Some people think they might form the basis of whole new industries. The interference effect, these optimists speculate, might be exploited to create holograms (that is, three-dimensional photographs) of actual matter, rather than mere images. That would be a completely new manufacturing technique for tiny components.

Pessimists retort, however, that these condensates exist only at extremely low temperatures. Dr Cornell and Dr Wieman had to plumb the icy depths of 20 billionths of a degree above absolute zero in order to win their prize. Things have improved a bit since then, but mass production of anything useful is decades off.

On the other hand

For the chemistry prize, the Royal Academy reverted to type. It chose the arcane but important area of chiral catalysis, in which the prize-winning work was done in the 1970s and 1980s.

The fact that a lot of molecules have left- and right-handed mirror-image forms (chiral enantiomers) might not seem very interesting, and for normal chemical work, it is not. But when such chemicals turn up in living organisms, they are frequently “single-handed”. Biological sugar molecules, for example, are right-handed. Amino-acids, the building blocks of proteins, are left-handed.

That frequently means that drugs need be single-handed, too. Often the only penalty for having an ambidextrous mixture is that half of it is wasted. But sometimes it matters more. The most notorious case was thalidomide. Experiments suggest that only one form causes limb damage, though the matter is still disputed.

Working independently, William Knowles, who retired from Monsanto, a drug company, 15 years ago, Ryoji Noyori, of Nagoya University, and Barry Sharpless, who now works at the Scripps Research Institute, in California, developed two sorts of catalyst that turn out chiral enantiomers in industrial quantities. An invisible improvement, perhaps, but an important one.

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Correction

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In "Truth or Consequences" (September 15th), we said that the Fourth International Peer Review Congress, held in Barcelona, was organised by the World Association of Medical Editors. The actual organisers were the *Journal of the American Medical Association* and the British Medical Journal Publishing Group. Sorry for the mistake.

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The Pill

Avoiding misconceptions

Oct 11th 2001
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The oral contraceptive celebrates its 50th birthday next week. Would it, could it, have been invented today?

Get article background

THOUSANDS of drugs have been launched during the past half century, but only one is known simply as “the Pill”. The oral contraceptive, which celebrates its half century on October 15th, was arguably the first lifestyle drug to control a normal bodily function—fertility—rather than a dread disorder. It transformed the lives of millions and also helped reshape the role of medicine in reproduction. Now, the medical, religious and social furore which greeted the Pill is largely forgotten. But it is admirably recalled by two new books which trace the Pill's tumultuous history and its uncertain future.

Sexual Chemistry: A History of the Contraceptive Pill
By Lara Marks

Yale; 352 pages; $29.95 and £20

Buy it at
Amazon.com
Amazon.co.uk

This Man's Pill. Reflections on the 50th Birthday of the Pill
By BY Carl Djerassi

Oxford University Press; 308 pages; $22.50 and £12.99

Buy it at
Amazon.com
Amazon.co.uk

Carl Djerassi's is by far the more personal account; and with good reason. Fifty years ago it was in his lab, at a small company called Syntex, in Mexico city, that a synthetic female sex hormone, called norethindrone, was first synthesised from a most unlikely source—yams. Syntex's goal was to create a drug for infertility and menstrual disorders which could be swallowed rather than injected. That it could also suppress ovulation, and thereby prevent pregnancy, was demonstrated by Gregory Pincus at the Worcester Foundation in Massachusetts, though the idea that naturally occurring hormones could be used as oral contraceptives was recognised as early as 1919 by Ludwig Haberlandt, a brilliant scientist now largely forgotten.

Mr Djerassi does a good job at explaining the chemistry behind the Pill and tracing the family tree of scientists which led to its creation. Lara Marks adds to this a thorough account of what happened to the Pill once it left the laboratory, and the long and complex clinical trials conducted by Dr Pincus and his colleague, John Rock, that were needed to get it to market. She also fleshes out the roles of Margaret Sanger, an American birth-control advocate, and Katherine McCormick, a rich philanthropist who supported Dr Pincus but whom Mr Djerassi largely ignores.

Both authors are critical of feminist attacks on the Pill and of claims that it was foisted on women by male scientists without adequate testing. As “Sexual Chemistry” points out, it is unfair to measure the drug's clinical development—much of which took place in Puerto Rico and other poor places—by today's standards. When the Pill came of age, the “population explosion” in developing countries was believed to be a fast track to communism and as dangerous to the western world as the atomic bomb. It was also before the thalidomide scares of the 1960s, which helped introduce tougher testing requirements.

The Pill has received much undeserved blame, as well as credit. It did not create the “sexual revolution”, nor has it destroyed family values. As both authors point out, all the Pill did was to expedite social changes already under way. It was revolutionary only in a technical sense, being the first drug that women could take on their own, at any time, to separate sex from procreation. The next generation of technologies to combat infertility—from *in-vitro* fertilisation to cloning—merely extend the great divide created by the Pill.

The Pill did not create the “sexual revolution”, nor has it destroyed family values

More than 80m women still use a variation of the Pill. Yet its popularity has declined since the 1960s, partly because of fears over thrombosis and cancer, and partly because the rise of AIDS has led to greater condom use and a rebalancing of the responsibility for contraception between men and women. Nor are there many drug companies interested in contraceptive development, largely because of the costs involved and fears of litigation due to complications. And yet there is a crying need for new methods of contraception, particularly ones better suited to people in the developing world. Although Mr Djerassi worries that contraceptive research is winding down, there have been a few interesting advances, particularly in regulating male fertility (see article). As the Pill enters middle age, contraception is still ripe for development.

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Nobel science prizes

Big fish

Oct 11th 2001
From The Economist print edition

ALFRED NOBEL, the Swedish industrialist who invented dynamite, shocked his family when he bequeathed the bulk of his substantial fortune in 1896 to create an annual prize for a small group of people “who, during the preceding year, shall have conferred the greatest benefit on mankind”. Nobel's will specified prizes in physics, chemistry, physiology or medicine, literature, and peace. The economics prize was first awarded in 1969. Robert Friedman's book traces the history of the physics and chemistry prizes, which have come to be seen as a hallmark of scientific achievement since the first awards in 1901.

The Politics of Excellence: Behind the Nobel Prize in Science
By Robert Marc Friedman

Times Books; 379 pages; $30 and £19.99

Buy it at
Amazon.com
Amazon.co.uk

Just how Nobel laureates are chosen has long been speculated on. The science candidates are nominated by certain Swedish academics, previous prize winners and a few invited foreign scientists. The final vote is cast by the entire Royal Swedish Academy of Sciences. However, as Mr Friedman argues, the decision is based also on subjective opinion, taste and politics. The five-person Nobel Committee plays a crucial role, evaluating candidates and making recommendations. Some insight into this process was gained in 1976 when the Nobel Foundation gave researchers access to its archives up to 1950. Mr Friedman has made extensive use of this material, and he gives detailed accounts of the committee's negotiations and the political machinations that surround them.

One problem for the early committees was deciding what Nobel had meant by his rather sketchy description of the prizes. Recipients should be worthy, but what qualifies a scientist as worthy? Should the prize go to older scientists with a lifetime of excellent research behind them or to younger figures who have made a startling discovery?

At the start of the first world war, the academy found itself under particular scrutiny. As Sweden tried to maintain its neutrality, the prizes were first postponed and then distributed between British, German and American scientists. This worked until 1918, when the chemistry prize was awarded to Fritz Haber, who had been a key figure in the German production of chemical weapons during the war (the prize was for his work on fertilisers).

That was not the committee's only muddle. Albert Einstein was nominated for a physics prize as early as 1910, but was voted down in the face of hostility towards theoretical physics. He was nominated again for his general theory of relativity, and Mr Friedman gives a fascinating description of the complicated process that led to the prize being first postponed and then awarded in 1921 for Einstein's work on the photoelectric effect.

Ultimately, Mr Friedman is sceptical about the Nobel prizes, which provoke frantic international competition. They focus public attention and professional aspiration on a narrow, and overly competitive, aspect of modern science, and ignore the importance of co-operative work. But scientists were competitive long before Nobel's legacy. For a few days, when the prizes were announced earlier this month, people concentrated on science and what it achieves for mankind (see article).

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Food in New York

Comfort eating

Oct 11th 2001
From The Economist print edition

WARM-HEARTED recollections of Jewish childhoods in New York are a rich literary genre. Once they were acted out in Brooklyn or on Manhattan's Lower East Side, where the kids played softball among the tenements. As the community bettered itself, the backgrounds and pastimes moved upmarket. Patricia Volk grew up first in an apartment on Riverside Drive, then in a large house on Long Island. She befriended the family's black maid and had riding lessons. Every year she attended extended family dinners at the Hotel New Yorker where relatives passed on the essential skills of choosing expensive baubles. (Never buy more than two pieces of matching jewellery. “Two is elegant, Patty. Three is tasteless.”)

Stuffed: Adventures of a Restaurant Family
By Patricia Volk

Knopf; 242 pages; $23. To be published in Britain by Bloomsbury in June 2002

Buy it at
Amazon.com
Amazon.co.uk

Vivid characters bound by strong family feelings are common to such memoirs, as, of course, are impressive quantities of food. Since Ms Volk's folks were in the restaurant business (her great-grandfather is supposed to have introduced pastrami to America) she is keen to pass on details of memorable mealtimes and even includes a few high-calorie recipes. But her father, Cecil Volk, was a deracinated Jew. His Garment District restaurant did not serve gefilte fish and knishes. Instead, his customers feasted on such high-ticket—and often non-kosher—items as lobster Newburg and duckling Montmorency. When traditional dishes did appear they were disguised in non-ethnic menu-speak, so that chicken soup became “Essence of Young Fowl with Matzo Dumplings”.

Ms Volk acknowledges her roots, relating how many of her mother's relatives were victims of the Holocaust and how her uncle escaped the Nazis on skis. Yet the Volks did not observe the faith. At home, bacon and pork chops were often on the menu. The family maintained the tradition of the seder on the first night of Passover, but stripped away its religious context. “We didn't have a Passover service. We didn't have prayer books. Our religion was getting together at my grandmother's to eat.” The drift of modern American Jews away from the orthodoxy of their forebears provides this funny and touching book with a thought-provoking subtext.

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Biography

Exposed

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From The Economist print edition

Storyteller: The Lives of Laurens van der Post
By J.D.F. Jones

John Murray; 505 pages; £25

Buy it at Amazon.co.uk

MATILDA, who “told such Dreadful Lies, It made one Gasp and Stretch one's Eyes”, is one of Hilaire Belloc's most enduring heroines. A similar scale of fibbing transformed Laurens van der Post, a pushy South African journalist of moderate gifts, into a British colonel, a Sir, and a world-famous wise man. At every page of this huge, hilarious book one is tempted to mutter: Whatever next?

The unharmed victims of Sir Laurens's deceptions included the British prime minister, the heir to the throne and a selection of millionaires. Those he damaged included several admirable women (who often went on loving him nonetheless) and, when he at last won real influence, many thousands of South Africans, slaughtered in Zululand's domestic conflict in the 1990s. Like all great con-men, he may have believed much of his own embroidery.

Sir Laurens was often ahead of his time; in 1929 he foretold the harm that apartheid would do South Africa. In the early 1950s he pioneered the woozy primitivism which is now called New Age. Some of his achievements were genuine: he bravely survived the Japanese prison camp in war-time Java, where he began his self-promotion—literally, from captain to lieutenant-colonel (even the assiduous Mr Jones cannot quite explain why the army amended his back pay to match his phoney rank). Claiming falsely to be a counsellor to Lord Mountbatten, at the time busy dismantling the British and Dutch oriental empires, Sir Laurens reported back in London to the prime minister, the foreign secretary and the chancellor of the exchequer.

He got away with it, saw no reason to stop, and went on in the same fashion until he was 90. He talked and talked, far better than he wrote, weaving other people's stories into his own, always, says Mr Jones, “to position himself at the centre”. He pinched narrative techniques from Joseph Conrad, and images and characters from the Edwardian imperial fantasists, Henry Rider Haggard (a knight) and John Buchan (a lord). That was how he made others happy and himself rich and famous.

There was something cajoling about his prose, something pat about the sequences of events that he purveyed, something soggy in the beliefs he espoused. Yet Mr Jones, with every fact nailed down to a source, is never censorious, and is vague only where the truth is veiled in a cloud of lies. Why did apparently rational people swallow this nonsense? Maybe Sir Laurens gave them what they wanted—heroism, idealism, religiosity and a touch of danger. His most famous project, in print and on television, was “The Lost World of the Kalahari”. It told of his empathy since childhood with the Bushmen of South Africa. The truth is that he first encountered them when he was over 40 and the folk-wisdom that he said he gathered around their camp-fires had been collected and published since the 1870s. Sir Laurens's book has been in print for more than 40 years, and the posthumous truth will now delight a different class of reader. Few authors have had such a long run, and, unwittingly, have provided so much fun.

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Hieronymus Bosch

Trouble and strife

Oct 11th 2001 | ROTTERDAM
From The Economist print edition

Finding the master is not easy

HIERONYMUS BOSCH'S painted Hell is peopled with the demons that bedevilled the medieval mind. There is the cloaked saint praying to be saved from the jaws of a bat, the Christ crowned with thorns by a hand protected with an armoured glove, the naked prone man being watched by a cold blue toad that is sitting on his genitals. But Bosch, who was born around 1450, also knew about forbidden pleasure. His lurid allegories detail every imaginable carnal sin and have been famous since the 16th century, when King Philip II of Spain hung Bosch's “Garden of Earthly Delights” in his bedroom, to warn against the weakness of the flesh.

The Boijmans van Beuningen museum in Rotterdam has assembled 18 of the 25 known Bosch paintings, as well as seven exquisite drawings that are rarely shown, for an exhibition that runs until November 11th. What should have been a once-in-a-lifetime presentation of this medieval master has instead been turned into something of a motorway pile-up. One reviewer demanded the museum director's resignation. What has gone wrong?

The curators' attempt to demystify Bosch could have had some merit, if only the enigmatic painter had not somehow got lost in the process. Bosch's idiosyncratic mix of images, both bawdy and biblical, was not heretical but part of the artistic culture of the day, the curators say. To prove their point, they include a dozen or so paintings by his forgettable (and forgotten) contemporaries, and rooms and rooms of pottery, prints and medals depicting men behaving badly, circa 1500. More controversially, the Boijmans strives to show Bosch as eternally relevant by surrounding him with works of 20th-century artists more or less inspired by him—salacious comic strips by Robert Crumb, the screaming soundtrack from Pippilotti Rist's video of a woman burning in the fires of Hell.

Mixing old and new is now the fashion among museum curators the world over. But does the new always illumine the old and make it more interesting? The museum's unorthodox director, Chris Dercon, believes such an approach to be essential because Bosch's grotesque imagery, his negotiation between sin and salvation, high and low culture, find echoes in 20th-century art. Mr Dercon believes that we should not bow to historical propriety, but challenge it instead. “We don't just want to present Bosch in his context, we want to look at the before and after of this artist—particularly at his enduring meaning to artists.” The show is ultimately disappointing. It makes glib comparisons, rather than tracing meaningful relationships. Yet nothing can diminish the power of Bosch's vision. See it, but be prepared to hunt for the gems.

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Karlheinz Stockhausen at the Barbican

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The godfather of electronic music has not mastered the sound-bite. At a Hamburg press conference, Karlheinz Stockhausen invited people to think of the September 11th attacks as the “greatest work of art ever”. Amid the furore, he explained he meant the greatest by Lucifer—a character in his opera-cycle “Licht”. But the damage was done, confirming that the guru-like composer is often wilfully out of touch with his planet. Fortunately, the music of this 20th-century master can be heard for itself, without the overlay of his wilder pronouncements. Parts of “Licht” and many of his other works feature in an electronic music festival at London's Barbican Hall (October 13th-18th).

J.Four/Lebrecht

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Iranian film

High as a horse

Oct 11th 2001
From The Economist print edition

Strange goings-on in the mountains

SCARCELY known, even to film buffs, Bahman Ghobadi is in the vanguard of a new and exciting generation of film makers from Iran. He comes from Iranian Kurdistan and his first feature film, “A Time for Drunken Horses”, pushes Iranian cinema on to fresh ground, almost literally. The harrowing story involves a smuggling trek over mountains so steep and perilous that the horses have to be plied with alcohol to get them through the journey.

Poor, teenaged Ayoub lives on the Iran-Iraq border. His mother is dead, his father gone, and he is the family provider. Though close in age, his younger brother suffers from an illness that has crippled his capacity for growth, and without treatment he will soon die. Ayoub tries to marry off his sister to an Iraqi Kurd for a dowry to pay for the operation. But the prospective in-laws renege. So Ayoub joins a gang smuggling tyres over the border into Iraq, in the hope of selling his mule there. At the border the plan goes awry in a bleak, if sardonic, fashion.

This tale of Kurds eking out subsistence is free of overt propaganda. It points no fingers inside or outside Iran. Instead, it leaves audiences to draw their own conclusions about what might be happening to Iran's ethnic minority and why.

“A Time for Drunken Horses” builds on features found in much of the best new Iranian cinema. It is filmed from a child's viewpoint. Indeed, as much of Iran's cinema is meant to teach children moral lessons, the challenge for film makers is to add a dimension that adults will also respond to. It is a constraint to which Mr Ghobadi magnificently responds. He cut his directorial teeth as assistant to the renowned Abbas Kiarostami on “The Wind Will Carry Us”. As an actor he had the lead in “Blackboards”, a groundbreaking second film from Samira Makhmalbaf, the 22-year-old daughter of another famous director from Iran, Mohsen Makhmalbaf.

Clearly, the energy of Iranian film shows no sign of dying away. Readers intrigued by this country's cinema can read more in a set of essays and interviews, “Close Up: Iranian Cinema Past, Present and Future” by Hamid Dabashi (Verso).

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American and European bestsellers

What the world is reading

Oct 11th 2001
From The Economist print edition

Bestselling fiction in the week of the Frankfurt book fair

IT IS rare for a literary author to outsell Stephen King and Nicholas Evans. Yet two weeks after it was featured on Oprah's Book Club, “The Corrections”, Jonathan Franzen's study of chronic domestic malaise, has struck a chord in America. So too has Rumi, a 13th-century Persian mystic. Though not listed below, his hymns to love and natural beauty are outselling more contemporary American poetry.

Harry Potter, meanwhile, has no need of Oprah. In Germany, the schoolboy wizard occupies four of the top ten slots. He doesn't feature on the American, Dutch and French lists because children's books are listed separately there. Dutch adults mix seriousness and fun: Renate Dorrestein's family drama, “Zonder genade”, and popular TV satirists, Jiskefet. The French are rediscovering a 1938 novel, “Inconnu à cette adresse”, which charts the estrangement of two friends, one a Jew, the other a Nazi.

Bestsellers

	DUTCH FICTION	FRENCH FICTION
1	**Zonder genade** *by Renate Dorrestein* Marriage in crisis after child's death	**Voyez comme on danse** *by Jean d'Ormesson* Graveside gravitas
2	**Dans van de luipaard** *by Lieve Joris* Congo adventure	**Plateforme** *by Michel Houellebecq* Sexual tourism and other modern maladies
3	**Gloed** *by Sandor Marai* Two friends reunited after 41 years	**Cosmétique de l'ennemi** *by Amélie Nothomb* Psychological thriller
4	**Het dagboek van Bridget Jones** *by Helen Fielding* Diary of a singleton	**La constance du jardinier** *by John le Carré* Diplomat takes on pharmaceutical giant
5	**Bridget Jones, het nieuwe dagboek** *by Helen Fielding* No longer a singleton, but still miserable	**La grammaire est une chanson douce** *by Erik Orsenna* The transforming magic of language
6	**Het bezoek van de lijfarts** *by Per Olov Enquist* Fictionalised life of 18th-century court doctor	**A ce soir** *by Laure Adler* A mother copes with the loss of her son
7	**Portret in Sepia** *by Isabel Allende* Family drama	**La vie sexuelle de Catherine M.** *by Catherine Millet* Art expert describes her sex life
8	**Magier** *by Wilbur Smith* Egyptian epic	**Inconnu à cette adresse** *by Kathrine Kressmann Taylor* Rediscovered classic
9	**De rode kamer** *by Nicci French* Psychological thriller	**Respire** *by Anne-Sophie Brasme* Teen angst
10	**Debiteuren-crediteuren deel 1** *by Jiskefet* Satirical sketches of office life	**Rouge Brésil** *by Jean-Christophe Rufin* Historical fiction of French conquistadores

	GERMAN FICTION	AMERICAN FICTION
1	**Baudolino** *by Umberto Eco* Battles, crusades and tall tales	**The Corrections** *by Jonathan Franzen* Gritty family drama
2	**Harry Potter und der Feuerkelch** *by J.K. Rowling* Harry in wizard tournament	**Black House** *by Stephen King and Peter Straub* Supernatural serial killer thriller
3	**Nie sollst du vergessen** *by Elizabeth George* Music, murder and memory loss	**A Bend in the Road** *by Nicholas Sparks* Love, death and a shocking secret
4	**Harry Potter und der Stein der Weisen** *by J.K. Rowling* Harry starts wizard school	**Cane River** *by Lalita Tademy* Semi-autobiographical family saga
5	**Harry Potter und der Gefangene von Askaban** *by J.K. Rowling* Convict on the run after trainee wizard	**Antrax** *by Terry Brooks* Second instalment in fantasy series
6	**Harry Potter und die Kammer des Schreckens** *by J.K. Rowling* More Harry and more wizardry	**Valhalla Rising** *by Clive Cussler* Latest Dirk Pitt adventure
7	**Das zweite Gedächtnis** *by Ken Follett* Cold war thriller	**Mercy** *by Julie Garwood* Steamy thriller in a swampy setting
8	**Der Welt den Rücken** *by Elke Heidenreich* Short story collection	**Envy** *by Sandra Brown* Editor finds romance in the slush pile
9	**Das sexuelle Leben der Catherine M.** *by Catherine Millet* Art expert describes her sex life	**The Smoke Jumper** *by Nicholas Evans* Forest fires and blazing hearts
10	**Weg der Träume** *by Nicholas Sparks* Love, death and a shocking secret	**Suzanne's Diary for Nicholas** *by James Patterson* Suspenseful love story

Sources: Libris; *Livres Hebdo; Focus; Publishers Weekly* Descriptions by *The Economist*

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Mike Mansfield

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Mike Mansfield, who saw out nine presidents, died on October 5th, aged 98

Corbis

A VETERAN Montana journalist, Charles Johnson, never forgot his first interview with Mike Mansfield. As a nervous cub reporter for the *Missoulian*, a small paper from a college town a long way from Washington, he did not want to waste the Senate majority leader's time. It was 1972. America was still at war in Vietnam. Mr Mansfield was a powerful and respected dove. How, the reporter stuttered, were the peace talks going? Mr Mansfield eyed him, excused himself and went to the telephone. On return, he said, “Well, I've just talked to Henry Kissinger at the White House, and he thinks...” Young Mr Johnson had his scoop, and Mr Mansfield, with more courtesy than effort, had made another quiet conquest.

Though his country is again at war, Mr Mansfield belongs to a different age in American politics, particularly on Capitol Hill, where he most left his mark. A Democrat, he served five terms in the House of Representatives and four in the Senate, where he was majority leader from 1961 to 1977, a record in recent times.

In his patient, unassuming manner, Mr Mansfield played a leading part there in bringing about two large shifts of political power. One was within the Senate itself, as the blocking ability of entrenched southern committee chairmen was broken up after decades of resistance, allowing the passage of civil-rights laws and Great Society social legislation. The other shift was between the Senate and the executive branch, as the foreign-policy freedom of the president and his intelligence agencies, greatly widened since the second world war, was reined in by new laws and closer Senate scrutiny.

When in 1960 John Kennedy chose Lyndon Johnson, then leader of the Senate, as his running mate, a member of his circle protested that Johnson, a conservative Texan, was not one of them. You don't get it, Kennedy rebuked him: he wanted Johnson to be vice-president so as to make way for Mr Mansfield, a majority leader he could work with. From his Senate position, Mr Mansfield went on to work with—and, when he saw fit, against—three more presidents. In 1968 Johnson complained that he could do with more support from his majority leader. “Mr President,” he shot back, “I'm not yours, I'm the Senate's.”

A hard start

Eugene McCarthy, a fellow senator who liked a fine phrase, said of Mr Mansfield that “a man of gentle exterior can be framed in steel”. His early years were certainly hard. He was born to Irish Catholic immigrants in New York, where his father was a hotel porter. His mother died when he was small, and he was packed off to relations in Montana, earning his keep pushing a grocery cart. In 1917, lying about his age, he ran away to the navy. On his return after the war, he worked in a copper mine. Preferring him above ground, his wife, Maureen Hayes, a teacher, urged him to better himself. He went to college in Missoula, and was soon a professor, teaching Latin American and Asian history.

Asia, indeed, was a lifetime interest, second only to Washington. Franklin Roosevelt included him, as a young congressman, in a fact-finding mission to wartime China (he foresaw a communist victory). Harry Truman sent him to advise on post-war Japan (he was for keeping the emperor). Richard Nixon exploited his Asian contacts in creating America's opening to China in 1972. When he finally retired from the Senate in 1977, Jimmy Carter made him ambassador to Japan. He was such a success in Tokyo that four years later Ronald Reagan asked him to stay. He remained until 1988, another record.

Neither witty nor eloquent, Mr Mansfield could be monosyllabic in public. In private, he poured out his views and frustrations, particularly on Vietnam. Instinct told him that the war could be successfully

opposed only from the centre. But war polarised America, and the centre temporarily vanished. Doveish critics complained that his opposition, as a consequence, was more persistent than effective.

A different criticism came from fellow Democrats in the Senate who wanted more partisan leadership. This was not his nature. Though a liberal, in the American sense, he was a deal-maker and conciliator, not a party manager or a warrior of ideas. He was especially proud of shepherding through a constitutional amendment lowering the voting age to 18, and he had strong views on many topics. But it is hard to find a doctrinal thread in a lifelong user of tobacco who favoured gun-control and fought to have the first Minutemen missiles installed in his home state.

Above all, Mr Mansfield respected the necessarily awkward arrangements of a complicated democracy. He saw his job as making them work, and that included giving opponents the benefit of the doubt. Over Watergate, he fully backed the Senate investigation that eventually exposed Nixon, though at first he thought deceitful aides must have misled the president.

Mr Mansfield was modest about his achievements, aware that changes seldom last. He left the Senate a more equal place than he found it. But after his day, it became more partisan again, and authority in peace and war swung back to the president. It is hard to think of a senator now of Mr Mansfield's steel or stature. Perhaps war will yet provide one.

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Overview

Oct 11th 2001
From The Economist print edition

Employment in **America's** non-farm sector fell by 199,000 in September, the biggest drop since the 1990-91 recession. The figures are mainly based on the period before September 11th, so they exclude several recent big lay-offs.

New figures for the **euro area** were mixed. German industrial production jumped by 2% in August, but this was distorted by an unusually large number of holidays in July, which depressed output. Production was 1.3% lower than a year earlier. Spain's industrial output rose by 2.8% over the same period. German unemployment rose in September, to 9.4% of the labour force.

Britain's industrial production jumped in August, thanks to a rebound in manufacturing, but output was still 2.3% down on a year earlier. Producer prices fell by 0.2% in the 12 months to September, their biggest annual fall since records began in 1958.

Deflation in **Japan** is getting worse. Wholesale prices fell by 0.6% in September, giving a 12-month decline of 0.2%. Domestic wholesale prices (excluding imports) fell by 1.1%, the biggest drop for two years. Nevertheless, Masaru Hayami, governor of the Bank of Japan, warned that more monetary easing could trigger hyperinflation.

Oil prices rose slightly after OPEC hinted at production costs of 1m barrels a day. Its basket price has been below the target range of $22-28 a barrel since September 24th.

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Output, demand and jobs

Oct 11th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	latest	latest	latest	year ago
Australia	+ 3.6	+ 1.4 Q2	+ 2.3	+ 3.5	– 0.4 Q2	+ 0.7 Q2	6.8 Aug	6.1
Austria	+ 1.6	+ 2.2 Q1	+ 1.6	+ 1.6	+ 4.6 Jul	– 3.3 May	3.9 Aug	3.6
Belgium	– 2.4	+ 1.7 Q2	+ 1.6	+ 1.6	+ 5.2 Jul*	+ 5.3 Jun	11.6 Aug*	11.9
Britain	+ 1.7	+ 2.3 Q2	+ 2.0	+ 1.9	– 2.3 Aug	+ 6.3 Aug	5.0 Jul†	5.3
Canada	+ 0.4	+ 2.1 Q2	+ 1.6	+ 1.8	– 3.6 Jul**	+ 3.5 Jun	7.2 Sep	6.9
Denmark	+ 2.4	+ 1.3 Q2	+ 1.2	+ 1.8	+ 0.8 Aug	– 0.5 Aug	5.1 Aug	5.4
France	+ 1.0	+ 2.3 Q2	+ 1.9	+ 1.6	+ 2.3 Jun	– 1.2 Jul	9.0 Aug	9.5
Germany	– 0.1	+ 0.6 Q2	+ 0.8	+ 1.2	– 1.3 Aug	+ 0.9 Jul	9.4 Sep	9.4
Italy	+ 0.1	+ 2.1 Q2	+ 1.8	+ 1.5	+ 1.7 Jul	– 1.5 Jul	9.4 Jul	10.5
Japan	– 3.2	– 0.7 Q2	– 0.5	– 0.4	–11.7 Aug	– 2.1 Jun	5.0 Aug	4.6
Netherlands	+ 1.6	+ 1.5 Q2	+ 1.4	+ 1.8	+ 0.7 Jun	+ 1.8 May	2.0 Aug§	2.5
Spain	+ 1.9	+ 2.9 Q2	+ 2.7	+ 2.2	+ 2.8 Aug	na	13.0 Aug	13.9
Sweden	+ 1.3	+ 1.4 Q2	+ 1.8	+ 2.0	– 2.6 Jun	+ 2.6 Jul	4.3 Aug*	5.1
Switzerland	+ 1.7	+ 2.0 Q2	+ 1.6	+ 1.6	+ 4.2 Q2*	+ 3.3 Jul	1.7 Sep*	1.7
United States	+ 0.3	+ 1.2 Q2	+ 1.0	+ 1.0	– 4.8 Aug	+ 4.3 Aug	4.9 Sep	3.9
Euro area	+ 0.2	+ 1.7 Q2	+ 1.6	+ 1.5	– 1.1 Jul	+ 1.3 Jul	8.3 Aug	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 6.7	+ 0.4 Q2	na	na	– 1.9 Aug	+ 6.8 Jun	7.8 Aug*	8.3
Greece	+ 2.8	+ 4.9 Q2	na	na	+ 0.3 May*	+ 8.1 May	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.2 Jul	1.3
Ireland	na	+13.2 Q1	na	na	– 2.3 Jul*	+ 6.2 Jul	3.7 Sep	3.8
Luxembourg	na	+ 8.52000	na	na	+ 4.3 Jun*	+ 8.2 Jul	2.4 Jul	2.6
New Zealand	+ 7.4	+ 2.8 Q2	na	na	+ 3.5 Q2*	+ 7.2 Q2	5.2 Q2	6.1
Norway	+ 0.5	+ 1.4 Q2	na	na	+ 0.9 Aug*	+ 0.4 Jul	3.6 Q2	3.3
Portugal	– 0.3	+ 2.2 Q1	na	na	– 1.2 Aug*	+ 5.5 Jun	3.9 Q2	3.8

*Not seasonally adjusted. † May-Jul; claimant count rate 3.1% in Aug. §Jun-Aug.**New series.

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Prices and wages

Oct 11th 2001
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 6.0	Q2	+ 3.2	+ 4.0	+ 2.5	+ 5.6	Q2	+ 7.4	+ 3.7	Q2	+ 3.9
Austria	+ 2.5	Aug	+ 2.7	+ 2.5	+ 1.6	+ 1.7	Aug	+ 4.3	+ 2.8	Aug	+ 1.9
Belgium	+ 2.3	Sep	+ 3.4	+ 2.6	+ 1.7	+ 4.0	Jul	+ 8.9	+ 2.6	Q2	+ 2.2
Britain	+ 2.1	Aug	+ 3.0	+ 2.0	+ 2.1	– 0.2	Sep	+ 2.5	+ 4.6	Jul	+ 3.9
Canada	+ 2.8	Aug	+ 2.5	+ 2.8	+ 2.0	+ 0.9	Aug	+ 3.9	+ 1.7	Jul	+ 1.1
Denmark	+ 2.3	Sep	+ 2.7	+ 2.4	+ 2.0	+ 1.5	Aug	+ 6.4	+ 4.7	Q2	+ 3.3
France	+ 1.9	Aug	+ 1.8	+ 1.9	+ 1.5	+ 0.7	Aug	+ 5.8	+ 4.2	Q2	+ 5.4
Germany	+ 2.1	Sep	+ 2.5	+ 2.4	+ 1.4	+ 1.5	Aug	+ 5.6	+ 1.4	Jul*	+ 2.0
Italy	+ 2.6	Sep	+ 2.6	+ 2.7	+ 1.8	+ 1.2	Aug	+ 6.5	+ 2.5	Aug*	+ 1.8
Japan	– 0.7	Aug	– 0.5	– 0.6	– 0.6	– 0.2	Sep	+ 0.4	– 4.1	Aug*	+ 2.0
Netherlands	+ 4.7	Sep	+ 2.9	+ 4.7	+ 2.2	+ 1.9	Aug	+ 7.8	+ 4.3	Aug	+ 3.3
Spain	+ 3.7	Aug	+ 3.6	+ 3.7	+ 2.4	+ 1.6	Aug	+ 5.1	+ 2.9	Q2†	na
Sweden	+ 3.1	Aug	+ 1.3	+ 2.3	+ 1.8	+ 1.5	Aug	+ 3.7	+ 1.9	Jul*	+ 4.0
Switzerland	+ 0.7	Sep	+ 1.4	+ 1.3	+ 1.1	– 0.2	Aug	+ 2.4	+ 1.3	2000	+ 0.3
United States	+ 2.7	Aug	+ 3.4	+ 3.1	+ 2.1	+ 2.1	Aug	+ 3.4	+ 4.3	Sep	+ 3.7
Euro area	+ 2.7	Aug	+ 2.3	+ 2.6	+ 1.7	+ 1.7	Aug	+ 5.6	+ 3.0	Q2	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.4	Aug	+ 3.8	na	na	– 0.1	Aug	+ 7.6	+ 4.8	Q2*	+ 4.6
Greece	+ 3.6	Sep	+ 3.1	na	na	+ 4.5	Jul	+ 7.7	na		na
Iceland	+ 8.4	Sep	+ 4.0	na	na	+ 6.8	Sep	+ 3.4	+ 8.8	Aug	+ 7.9
Ireland	+ 4.6	Aug	+ 6.2	na	na	+ 2.6	Aug	+ 6.5	+ 8.1	Q1*	+ 6.1
Luxembourg	+ 2.8	Aug	+ 3.1	na	na	+ 0.4	Jul	+ 6.7	+ 7.8	Jun*	+ 5.3
New Zealand	+ 3.2	Q2	+ 2.0	na	na	+ 8.1	Q2	+ 5.9	+ 1.8	Q2	+ 1.7
Norway	+ 2.4	Sep	+ 3.5	na	na	–11.0	Sep	+ 7.4	+ 4.4	Q2*	+ 3.9
Portugal	+ 4.0	Aug	+ 3.5	na	na	– 0.2	Aug	+14.2	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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Portfolio poll

Oct 11th 2001
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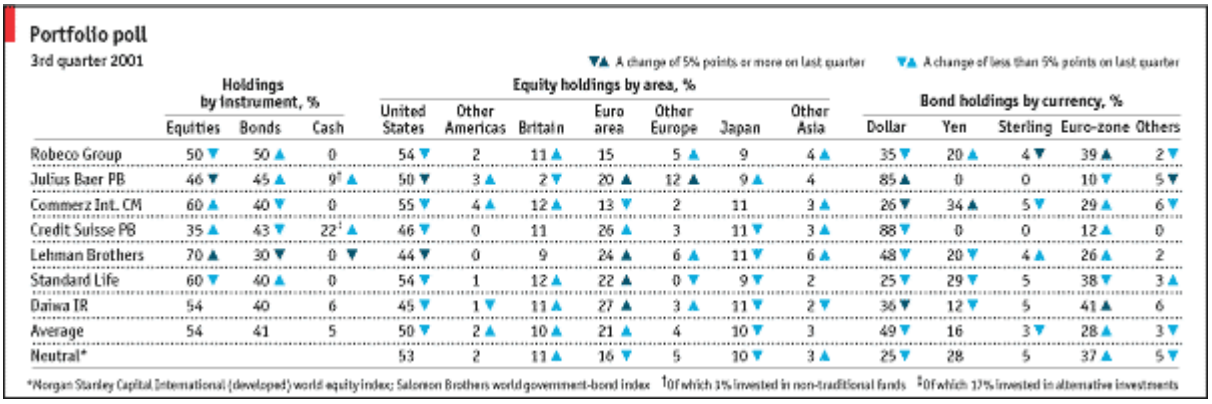

Portfolio poll

3rd quarter 2001

▼▲ A change of 5% points or more on last quarter ▼▲ A change of less than 5% points on last quarter

	Holdings by instrument, %			Equity holdings by area, %							Bond holdings by currency, %				
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia	Dollar	Yen	Sterling	Euro-zone	Others
Robeco Group	50 ▼	50 ▲	0	54 ▼	2	11 ▲	15	5 ▲	9	4 ▲	35 ▼	20 ▲	4 ▼	39 ▲	2 ▼
Julius Baer PB	46 ▼	45 ▲	9[2] ▲	50 ▼	3 ▲	2 ▼	20 ▲	12 ▲	9 ▲	4	85 ▲	0	0	10 ▼	5 ▼
Commerz Int. CM	60 ▲	40 ▼	0	55 ▼	4 ▲	12 ▲	13 ▼	2	11	3 ▲	26 ▼	34 ▲	5 ▼	29 ▲	6 ▼
Credit Suisse PB	35 ▲	43 ▼	22[1] ▲	46 ▼	0	11	26 ▲	3	11 ▼	3 ▲	88 ▼	0	0	12 ▲	0
Lehman Brothers	70 ▲	30 ▼	0 ▼	44 ▼	0	9	24 ▲	6 ▲	11 ▼	6 ▲	48 ▼	20 ▼	4 ▲	26 ▲	2
Standard Life	60 ▼	40 ▲	0	54 ▼	1	12 ▲	22 ▲	0 ▼	9 ▼	2	25 ▼	29 ▼	5	38 ▼	3 ▲
Daiwa IR	54	40	6	46 ▼	1 ▼	11 ▲	27 ▲	3 ▲	11 ▼	2 ▼	36 ▼	12 ▼	5	41 ▲	6
Average	54	41	5	50 ▼	2 ▲	10 ▲	21 ▲	4	10 ▼	3	49 ▼	16	3 ▼	28 ▲	3 ▼
Neutral*				53	2	11 ▲	16 ▼	5	10 ▼	3 ▲	25 ▼	28	5	37 ▲	5 ▼

*Morgan Stanley Capital International (developed) world equity index; Salomon Brothers world government-bond index [1]Of which 1% invested in non-traditional funds [2]Of which 12% invested in alternative investments

After the attacks on the World Trade Centre the spectre of world recession has become more threatening. The investment managers we survey each quarter have reacted with heightened caution. Lehman Brothers is an exception, with a big increase in its holdings of equities and a reduction of its cash holdings to zero. Most others have either reduced their allocations to equities and raised cash holdings, or left both at previous levels. Not surprisingly, our moneymen have shied away from shares in companies in America, where the terrorist acts took place. Europe also seems safer than Japan. Many have increased significantly their holdings in European equities. For similar reasons, all have reduced bond holdings in dollars and shifted towards euro-denominated bonds.

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Money and interest rates

Oct 11th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 10th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+14.7	+ 7.7	Aug	4.38	6.43	4.10	5.40	6.14	6.85
Britain	+ 7.3	+ 7.1	Aug	4.41	6.13	4.59	4.77	5.11	6.16
Canada	+ 7.6	+ 3.6	Aug	2.98	5.62	3.48	5.32	5.72	7.09
Denmark	+ 6.7	+ 2.3	Aug	4.00	5.60	3.95	4.85	5.46	6.97
Japan	+11.8	+ 3.7	Sep	0.01	0.43	0.06	1.39	1.80	1.46
Sweden	+ 6.6	+ 2.5	Aug	3.71	3.97	4.01	5.19	5.17	5.16
Switzerland	+ 0.1	+ 2.6	Aug	2.12	3.54	3.52	3.05	3.73	4.60
United States	+ 4.0	+10.9	Aug	2.30	6.53	2.77	4.59	5.78	6.84
Euro area†	+ 3.1	+ 6.6	Aug	3.62	5.07	3.39	4.63	5.11	5.63

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.37%, Japan No.234 1.40%. Central bank rates: US fed funds 2.50%, ECB refinancing 3.75%, BOJ overnight call 0.002%, BOE repo 4.50%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 11th 2001
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1995=100

	Oct 2nd	Oct 9th*	% change on one month	% change on one year
Dollar index				
All items	63.7	63.2	– 5.2	–13.3
Food	65.6	65.3	– 3.7	– 8.9
Industrials				
All	61.2	60.4	– 7.3	–19.1
Nfa†	58.7	58.0	–11.6	–13.7
Metals	63.3	62.5	– 3.5	–22.9
Sterling index				
All items	68.5	68.0	– 5.0	–14.4
Euro index				
All items	91.5	90.6	– 6.3	–18.0
Yen index				
All items	81.9	80.8	– 4.1	– 3.6
Gold				
$ per oz	290.50	289.25	+ 0.3	+ 6.2
West Texas Intermediate				
$ per barrel	22.30	22.49	–18.6	–33.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 11th 2001
From The Economist print edition

Market indices

	Oct 10th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,073.7	3,425.2	2,867.4	+ 0.4	-10.3	- 2.6	-12.0
Austria (ATX)	1,050.1	1,245.8	1,050.1	- 4.1	-39.5	- 2.2	- 5.0
Belgium (Bel 20)	2,701.0	3,030.4	2,322.6	+ 2.3	-26.6	-10.7	-13.3
Britain (FTSE 100)	5,153.1	6,334.5	4,433.7	+ 5.6	-25.6	-17.2	-19.6
Canada (Toronto Composite)	6,952.3	9,348.4	6,513.1	+ 0.7	-39.0	-22.2	-25.4
Denmark (KBX)	220.8	294.3	197.8	+ 4.6	-26.8	-16.6	-18.7
France (SBF 250)	2,740.5	3,820.2	2,335.3	+ 7.2	-37.6	-27.3	-29.5
(CAC 40)	4,319.4	5,998.5	3,652.9	+ 7.3	-37.6	-27.1	-29.2
Germany (Xetra DAX)	4,613.2	6,795.1	3,787.2	+ 4.0	-42.8	-28.3	-30.4
Italy (BCI)	1,321.3	1,948.4	1,082.9	+ 4.0	-39.5	-31.0	-33.1
Japan (Nikkei 225)	9,964.9	14,529.4	9,504.4	+ 0.4	-74.4	-27.7	-31.4
(Topix)	1,031.2	1,441.0	863.4	- 1.8	-64.3	-19.7	-23.7
Netherlands (AEX)	471.4	642.3	396.2	+ 7.5	-32.8	-26.1	-28.2
Spain (Madrid SE)	747.8	963.9	648.6	+ 4.3	-34.8	-15.1	-17.6
Sweden (Affarsvarlden Gen)	200.0	293.1	177.5	+ 4.1	-50.0	-28.0	-35.8
Switzerland (Swiss Market)	5,976.9	8,135.4	5,110.2	+ 2.0	-28.9	-26.5	-26.9
United States (DJIA)	9,240.9	11,337.9	8,235.8	+ 1.3	-21.2	-14.3	-14.3
(S&P 500)	1,080.2	1,373.7	965.8	+ 0.8	-29.3	-18.2	-18.2
(Nasdaq Comp)	1,626.3	2,859.2	1,423.2	+ 2.9	-67.8	-34.2	-34.2
Europe (FTSE Eurotop 300)*	1,172.8	1,545.5	998.9	+ 4.9	-31.2	-23.5	-25.8
Euro area (FTSE Ebloc 100)*	1,013.6	1,404.1	843.6	+ 6.1	-34.6	-27.2	-29.3
World (MSCI)†	957.2	1,249.2	856.6	+ 1.6	-33.9	na	-21.6
World bond market (Salomon)‡	454.6	458.1	420.6	- 0.5	- 1.1	na	+ 2.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Oct 11th 2001
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	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Oct 10th	Exchange rate trade-weighted† year ago	Currency units per $ Oct 10th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	+ 1.5 Aug	− 9.9 Q2	− 2.9	− 3.2	69.5	72.4	1.99	1.86	2.89	1.82	1.66	0.1
Austria	− 5.3 Jun	− 4.7 Jul	− 2.6	− 2.5	100.3	99.1	15.1	15.8	21.9	13.8	12.6	-0.6
Belgium	+ 10.6 Jul	+ 8.9 Jun	+ 4.1	+ 4.3	99.3	97.6	44.3	46.2	64.2	40.3	36.8	0.7
Britain	− 45.9 Jul	− 19.2 Q2	− 1.9	− 2.4	105.2	108.3	0.69	0.68	–	0.63	0.57	1.2
Canada	+ 47.4 Jul	+ 25.5 Q2	+ 2.6	+ 1.9	76.5	79.4	1.57	1.50	2.27	1.43	1.30	2.6
Denmark	+ 6.8 Jul	+ 4.6 Jul	+ 1.8	+ 1.7	103.0	99.9	8.16	8.52	11.8	7.44	6.78	2.9
France	+ 0.2 Jul	+ 17.4 Jul	+ 1.5	+ 1.5	101.9	100.1	7.20	7.51	10.4	6.56	5.98	-0.5
Germany	+ 64.1 Aug	− 21.3 Jul	− 1.0	− 0.9	98.9	96.6	2.15	2.24	3.11	1.96	1.78	-1.7
Italy	+ 2.8 Jul	− 3.8 Jun	− 0.3	− 0.2	72.7	71.4	2,125	2,216	3,082	1,936	1,766	-1.3
Japan	+ 84.3 Jul	+ 92.5 Jul	+ 2.0	+ 1.9	139.3	157.5	120	108	174	110	–	-6.3
Netherlands	+ 18.6 Jul	+ 13.7 Q2	+ 4.0	+ 4.1	98.2	96.3	2.42	2.52	3.51	2.20	2.01	1.3
Spain	− 38.3 Jul	− 16.6 Jun	− 2.7	− 2.7	74.4	73.2	183	190	265	166	152	nil
Sweden	+ 12.1 Aug	+ 5.2 Jul	+ 1.9	+ 2.1	72.7	79.9	10.57	9.85	15.3	9.64	8.79	3.6
Switzerland	+ 0.5 Aug	+ 27.0 Q2	+10.6	+10.5	111.6	107.2	1.63	1.73	2.36	1.48	1.35	na
United States	−450.6 Jul	−449.9 Q2	− 4.2	− 4.0	117.7	113.9	–	–	1.45	0.91	0.83	2.1
Euro area	+ 7.1 Jul	− 29.4 Jul	− 0.3	− 0.2	79.5	76.1	1.10	1.14	1.59	–	0.91	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.8 Jul	+ 9.1 Jul	na	na	79.0	76.1	6.52	6.80	9.46	5.94	5.42	5.3
Greece	− 7.4 Jun	− 7.7 Jan	na	na	57.6	56.8	374	389	542	341	311	nil
Iceland	− 0.3 Aug	− 0.9 Q1	na	na	na	na	101	83.8	147	92.3	84.2	2.4
Ireland	+ 30.3 Jul	− 1.3 Q1	na	na	87.9	85.1	0.86	0.90	1.25	0.78	0.71	4.5
Luxembourg	− 2.9 Jun	+ 1.2 Q2	na	na	99.3	97.6	44.3	46.2	64.3	40.4	36.8	3.6
New Zealand	+ 0.2 Aug	− 1.9 Q2	na	na	78.4	74.0	2.42	2.46	3.51	2.21	2.01	1.0
Norway	+ 27.6 Aug	+ 26.6 Jul	na	na	96.9	92.1	8.77	9.25	12.7	7.99	7.29	15.3
Portugal	− 13.6 Jun	− 9.4 Jul	na	na	89.6	88.2	220	229	319	201	183	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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Stockmarkets

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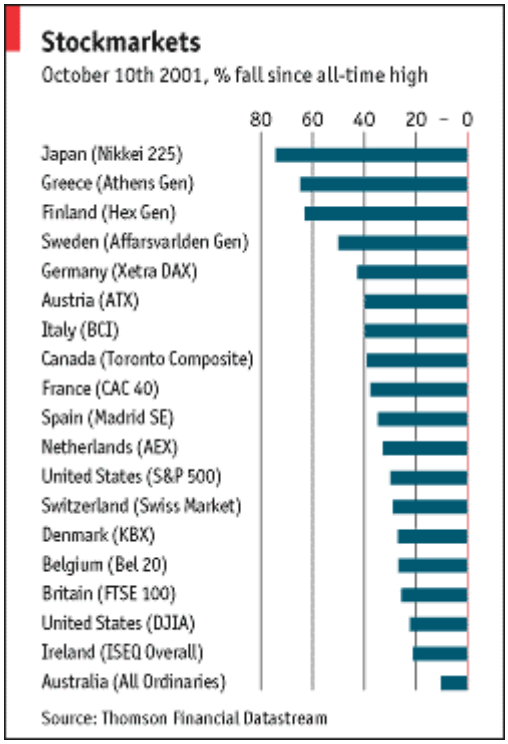

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Overview

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In **Argentina,** bond prices fell after Standard & Poor's downgraded the credit rating of long-term public debt. Argentina's yield premium over American Treasury bonds jumped to 19 percentage points, above the level before its IMF rescue. The government's fiscal woes have been aggravated by a 14% drop in tax revenue in the year to September—the result of a deep recession. Consumer prices fell by 1.1% in the year to September.

According to a provisional estimate, **Singapore's** GDP fell at an annual rate of 9.9% in the third quarter, to give a year-on-year decline of 5.6%. **Malaysia's** industrial production tumbled by 7.3% in the year to August. **Manila's** stockmarket fell by 9% in a week, on worries about an American recession. On October 10th the index fell below 1,000 for the first time since 1991.

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Population density

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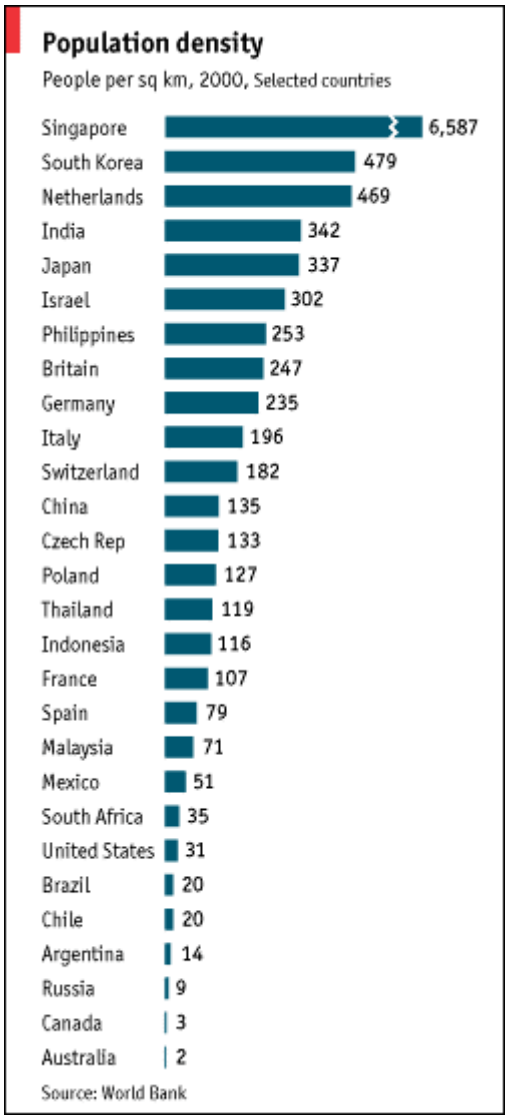
Singapore is the most cramped of the countries in the chart, with 6,587 people per square kilometre. Australians are less likely to bump into each other, with only two people per square kilometre—but much of their land is desert.



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Economy

Oct 11th 2001
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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.8	Q2	+ 8.1	Aug	+ 1.0	Aug	+18.8	Aug	+20.5	2000	187.5	Jul
Hong Kong	+ 0.5	Q2	– 0.1	Q2	– 1.1	Aug	–12.0	Aug	+ 8.2	Q2	113.4	Sep
India	+ 4.4	Q2	+ 2.6	Jul	+ 5.2	Aug	– 5.7	Aug	– 2.3	Q1	42.0	Sep
Indonesia	+ 3.5	Q2	+ 7.5	Q1	+13.0	Sep	+24.8	Aug	+ 6.3	Q1	28.2	Jul
Malaysia	+ 0.5	Q2	– 7.3	Aug	+ 1.3	Aug	+15.7	Aug	+ 7.4	Q1	26.9	Jul
Philippines	+ 3.3	Q2	– 2.1	Jul	+ 6.1	Sep	+ 4.5	Jul	+ 6.9	Jun	12.3	Jul
Singapore	– 5.6	Q3	–21.4	Aug	+ 0.7	Aug	+ 4.2	Aug	+22.6	Q2	74.0	Jul
South Korea	+ 2.7	Q2	– 4.7	Aug	+ 3.2	Sep	+11.5	Sep	+12.1	Aug	97.0	Jul
Taiwan	– 2.4	Q2	– 8.2	Aug	– 0.5	Sep	+13.0	Sep	+14.1	Q2	113.1	Aug
Thailand	+ 1.9	Q2	+ 1.4	Aug	+ 1.4	Sep	+ 2.9	Aug	+ 6.7	Aug	32.6	Aug
Argentina	– 0.5	Q2	– 5.6	Aug	– 1.1	Sep	+ 3.4	Aug	– 8.4	Q2	16.7	Jul
Brazil	+ 0.8	Q2	nil	Aug	+ 7.3	Aug	– 1.1	Aug	–27.1	Aug	35.5	Jul
Chile	+ 3.4	Q2	+ 1.7	Aug	+ 3.9	Sep	+ 1.5	Aug	– 1.6	Q2	14.7	Aug
Colombia	+ 1.6	Q2	+ 0.5	Jul	+ 8.0	Aug	+ 0.9	Jul	– 0.7	Q1	9.5	Jul
Mexico	nil	Q2	– 3.3	Jul	+ 5.9	Aug	– 9.5	Aug	–17.5	Q2	41.2	Aug
Peru	– 0.8	Jul	– 3.3	Aug	+ 0.9	Sep	– 0.2	Jul	– 1.4	Q2	8.8	Jul
Venezuela	+ 2.9	Q2	na		+12.3	Sep	+15.6	Q2‡	+11.1	Q2	10.6	Jul
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.2	Jul	– 9.9	Q1	– 0.2	Q1	13.0	Jun
Israel	+ 1.4	Q2	– 5.8	Jul	+ 1.7	Aug	– 7.3	Aug	– 1.1	Q1	24.2	Oct
South Africa	+ 2.5	Q2	+ 0.6	Aug	+ 4.6	Aug	+ 4.3	Aug	+ 0.4	Q2	6.0	Aug
Turkey	– 9.3	Q2	–10.1	Aug	+61.8	Sep	–19.3	Jul	– 3.1	Jul	17.2	Jul
Czech Republic	+ 3.9	Q2	+ 9.3	Jul	+ 4.7	Sep	– 3.5	Aug	– 2.7	Q2	13.4	Aug
Hungary	+ 4.0	Q2	+ 1.5	Aug	+ 8.7	Aug	– 2.3	Aug	– 1.4	Aug	12.0	Aug
Poland	+ 0.9	Q2	+ 0.7	Aug	+ 5.1	Aug	– 9.6	Aug	– 6.2	Aug	27.3	Sep
Russia	+ 5.1	Q2	+ 5.1	Aug	+20.1	Sep	+58.4	Jul	+44.6	Q2	33.7	Aug
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*												
Pakistan	+ 3.3	2001†	+10.2	Jun	+ 3.4	Aug	– 1.5	Jul	– 1.1	2001†	1.3	Jun
Saudi Arabia	+ 4.5	2000§	na		– 0.3	Jul	+50.9	2000	+15.6	2000	17.0	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Oct 11th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 10th		Dec 31st 2000	
	Oct 10th	year ago	Oct 10th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.0	na	1,760.8	−4.5	−19.7	−19.7
Hong Kong	7.80	7.80	11.3	2.18	10,298.2	+4.1	−31.8	−31.8
India	48.0	46.3	69.7	7.00	2,896.6	+5.1	−27.1	−29.1
Indonesia	9,985	8,855	14,483	17.95	368.3	−0.9	−11.5	−14.3
Malaysia	3.80	3.80	5.51	3.30	603.9	−2.1	−11.1	−11.1
Philippines	51.8	47.4	75.1	13.31	991.4	−9.0	−33.7	−35.9
Singapore	1.81	1.75	2.63	1.25	1,365.6	+2.3	−29.1	−32.3
South Korea	1,303	1,123	1,890	4.26	503.5	+5.0	−0.2	−3.1
Taiwan	34.6	31.3	50.1	2.90	3,618.9††	+5.0	−23.7	−27.0
Thailand	44.8	43.0	65.0	3.00	286.7	+3.9	+6.5	+3.2
Argentina	1.00	1.00	1.45	44.10**	224.1	+4.4	−46.3	−46.3
Brazil	2.77	1.86	4.02	19.09	10,462.3	+2.2	−32.9	−52.8
Chile	715	566	1,037	1.47*	4,981.6	−0.7	+2.3	−17.9
Colombia	2,325	2,176	3,372	11.56	860.7	−7.0	na	na
Mexico	9.40	9.48	13.6	9.12	5,684.9	+5.1	+0.6	+2.9
Peru	3.47	3.50	5.0	6.88	1,131.9	−5.5	−6.3	−4.9
Venezuela	743	692	1,077	15.01	6,648.6	−5.4	−2.1	−7.8
Egypt	4.25	3.69	6.16	8.86	5,498.2	+0.1	−28.2	−34.3
Israel	4.33	4.07	6.27	4.47	370.8	+4.2	−25.0	−29.9
South Africa	9.22	7.38	13.4	8.93	8,426.3	+2.3	+1.2	−16.9
Turkey	1,641,000	670,170	2,380,271	57.00	8,048.3	+4.9	−14.7	−65.2
Czech Republic	36.9	40.6	53.5	5.32	350.6	+4.8	−26.7	−25.3
Hungary	281	301	407	10.88	6,472.8	+2.8	−17.5	−17.1
Poland	4.14	4.63	6.00	14.99	12,522.1	+8.3	−29.8	−30.0
Russia	29.5	27.9	42.9	25.00	183.9	+5.6	+32.3	+28.3
EMF (MSCI)‡	1.00	1.00	1.45	na	257.2	+4.1	na	−23.0
EMBI+§	1.00	1.00	1.45	na	198.4	−0.5	na	−1.7

*Inflation adjusted.†In $ terms.‡Emerging Markets Free.§J.P. Morgan Chase's Emerging Markets Bond Index Plus.**New series.††Oct 9th.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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